

ARKANSAS CORPORATION INCOME TAX REGULATIONS

Pursuant to the authority vested in the Commissioner of Revenue and in compliance with Ark. Code Ann. §26-18-301 and §26-51-104, the Commissioner of Revenue of the Department of Finance and Administration, with the approval of the Governor, does hereby promulgate the following rules and regulations for the enforcement and administration of Ark. Code Ann. §26-51-101 et seq.

EFFECTIVE DATE: These regulations shall be effective for tax years beginning on and after January 1, 1998. All currently existing Arkansas corporate income tax regulations (with the exception of 1996-3) are hereby specifically repealed as of the effective date of these regulations.

PURPOSE OF THE REGULATIONS: The following regulations are promulgated to implement and clarify the Arkansas Income Tax Act of 1929 (§26-51-101 et seq.), as amended. All persons affected by or relying upon these regulations are advised to read them in their entirety, as the meaning of the provisions of one regulation may depend upon the provisions contained in another regulation.

INTERPRETATION: In those instances where Arkansas has adopted a section of the Internal Revenue Code (IRC) as its own law, the regulations promulgated by the Treasury Department to aid in interpreting the IRC section should be used for guidance in applying Arkansas' law.

2-8-101 BIOTECHNOLOGY DEVELOPMENT AND RESEARCH

1.2-8-101 Biotechnology Tax Credit

Biotechnology tax credits are issued and verified through the Department's Tax Credits/Special Refunds Section. Original certificates must be obtained from the Arkansas Economic Development Commission and must be attached to the corporation income tax return in order to claim the credit. Credit is limited to the first \$50,000 of income tax liability arising during each year and fifty percent (50%) of any remaining income tax liability for each year. Unused tax credits may be carried forward for up to nine (9) consecutive tax years following the tax year in which the credit originated. A taxpayer who receives a biotechnology tax credit for the purchase of machinery or equipment shall not be entitled to claim any other state or local tax credits or deductions based on the purchase of such machinery or equipment (other than the deduction for normal depreciation).

This tax credit shall be available for tax years beginning on 01/01/97 and thereafter.

Example:

The tax liability before credits of ABC Corporation for 1997 is \$81,273. The ABC Corporation has available a \$75,000 biotechnology tax credit. The 1997 tax liability for ABC Corporation is computed as follows:

1997 tax liability	\$ 81,273
Less: credit limit of \$50,000	<u>(50,000)</u>
Pre-adjusted tax liability	\$ 31,273
Less: 50% of remaining liability	<u>(15,636)</u>
Adjusted tax liability	\$ 15,637
 Biotechnology tax credits	 \$ 75,000
Less: credits applied towards tax	<u>(65,636)</u>
Available tax credit carryforward	\$ 9,364

15-4-1224 COUNTY AND REGIONAL INDUSTRIAL DEVELOPMENT CORPORATION ACT

1.15-4-1224 Income Tax Credit

The original purchaser of common stock in a County or Regional Industrial Development Corporation shall be entitled to a credit against any Arkansas income tax liability that the purchaser may have. The credit shall be determined as follows:

Example:

Purchase price	\$1,000,000
Credit allowed is	
33% of the purchase price	\$330,000
of the common stock	

Tax year	1991	1992	1993
Tax liability	20,000	50,000	80,000
Credit allowed	10,000	25,000	40,000
(50% of tax liability)			

2.15-4-1224 Gain or Loss Upon Sale or Disposition of Common Stock

The basis for computation of gain or loss upon the sale of the common stock in a County or Regional Industrial Development Corporation shall be reduced by the amount of the income tax credits previously deducted. The basis shall be further reduced by ten percent (10%) of the original purchase price if the stock is disposed of within five years (5) of its original purchase date.

Example:

Stock purchased in 1991, sold in 1994

Purchase price	\$1,000,000
Less credit claimed	- 75,000
Less 10% of purchase price	<u>-100,000</u>
Basis of stock for Arkansas tax purposes	825,000
Selling price	<u>1,500,000</u>
Taxable gain	\$ 675,000

15-4-1704 ARKANSAS ENTERPRISE ZONE ACT

1.15-4-1704 Income Tax Credits

Enterprise zone credits are issued and verified through the Department's Tax Credits/Special Refunds Section. Original certificates must be attached to the Corporation income tax return in order to claim the tax credits. The tax credits must be used for the tax year in which the increase in average annual employment occurred. The tax credits should be used to the full extent of the computed tax for the initial and succeeding tax years. Any unused credits may be carried forward for up to four (4) consecutive tax years following the tax year in which the credit originated **if approved prior to 03/25/97** or for up to nine

(9) consecutive tax years following the tax year in which the credit originated **if approved on or after 03/25/97**. If more than one (1) credit is involved, the taxpayer should specify in which order the credits should be claimed. If the taxpayer does not specify the order, the credits will be applied in the order which will be of best advantage to the taxpayer.

Regional headquarters and steel service centers (SIC 5051) may qualify for the tax incentive credits. These taxpayers must employ fifty (50) or more new permanent employees and must not make retail sales to the general public.

Under prior law, new employees were required to be Arkansas residents. The law now requires only that a new employee be an Arkansas taxpayer during the tax year in which the credit was issued.

15-5-1301 AFFORDABLE NEIGHBORHOOD HOUSING

1.15-5-1301 Housing Tax Credit

This tax credit applies to any taxpayer who provides affordable housing assistance that has been qualified by the Arkansas Development Finance Authority ("ADFA"). The ADFA establishes the requirements for this credit and issues a certificate of eligibility for tax credit. This certificate must be attached to the taxpayer's income tax return upon which the tax credit is first taken.

The allowable credit cannot exceed thirty (30%) percent of the total amount invested in affordable housing assistance activities by the taxpayer. If not fully used in the year established, this credit may be carried forward for up to five (5) consecutive tax years following the tax year in which the credit originated.

The affordable neighborhood housing tax credit applies to tax years ending after August 1, 1997 and is available on a first come, first served basis until a \$750,000 per year limit for all taxpayers is reached.

26-18-208 TAX PENALTIES

1.26-18-208(6)(A) Estimated Tax Penalty

Payments made with an extension of time to file corporation income tax returns do not constitute estimated tax payments. Estimated tax payments must be made by the required due dates.

Underestimate penalty is calculated by multiplying the underpayment for each quarter by .00027397 and then multiplying that figure by the number of days underpaid. There can be several calculations for each quarter when partial payments are

received.

Example 1:

Corporation "A" FEIN 99-9999991, is a calendar year filer. The tax liability for tax year 12/94 was \$40,000 and for tax year 12/95, the tax liability was \$20,000. "A" has a \$2,000 estimate credit carryforward from tax year 12/94. "A" filed an extension payment of \$3,000 on 5/15/96. The 12/95 income tax return was filed 9/15/96. "A" paid estimated tax payments for tax year 12/95 as follows:

PAYMENT DATE	VOUCHER NO.	AMOUNT
05/15/95	1	\$3,000
01/15/96	4	10,000

The required estimated tax due per quarter is \$4,500 ($\$20,000 \times 90\% \div 4$). \$500 of the 1st quarter overpayment ($\$3,000 + \$2,000 - \$4,500$) is applied to the 2nd quarter estimate. The \$10,000 4th quarter payment will be applied to the 2nd, 3rd and 4th quarter required estimates as follows: (1) \$4,000 to the 2nd quarter, (2) \$4,500 to the 3rd quarter, and (3) \$1,500 to the 4th quarter. The amount subject to underestimate penalty and the penalty calculations are as follows:

Quarter	Quarterly Due Date	Payment Date	Underpay Amount	Underpaid Days	U/P amt x U/P days x .00027397
2nd	6/15/95	1/15/96	\$4,000	214	\$235
3rd	9/15/95	1/15/96	4,500	122	150
4th	1/15/96	*5/15/96	3,000	121	99
Total UEP					----- \$484

*5-15-96 is the original income tax return due date.

Example 2:

Corporation "B", FEIN 99-9999992, is a fiscal year filer. The tax liability for tax year 3/94 was \$15,010 and for tax year 3/95, the tax liability was \$16,644. Corporation "B" filed an extension payment of \$7,940 on 8/15/95. The income tax return was filed on 12/15/95. "B" paid estimated tax payments for tax year 3/95 as follows:

PAYMENT DATE	VOUCHER NO.	AMOUNT
08/15/94	1	\$3,000
12/15/94	4	10,000

The required estimated tax due per quarter is \$3,745 ($\$16,644 \times$

90% ÷ 4). The \$10,000 4th quarter overpayment will be applied to the 1st, 2nd and 3rd quarters as follows:

(1) \$745 to the 1st quarter, (2) \$3,745 to the 2nd quarter, (3) \$3,745 to the 3rd quarter, and (4) \$1,765 to the 4th quarter. The amount subject to underestimate penalty and the penalty calculations are as follows:

Quarter	Quarterly Payment Due Date	Payment Date	Underpay Amount	Underpaid Days	U/P amt x U/P days x .00027397
1st	8/15/94	12/15/94	\$ 745	122	\$25
2nd	9/15/94	12/15/94	3,745	91	93
4th	4/15/95	*8/15/95	1,765	122	59

Total UEP					\$177

*8-15-95 is the original income tax return due date.

1.26-18-208(6)(B)(iii) Estimated Tax Penalty

The estimated tax penalty will not be imposed if estimated tax payments equal or exceed the amount of tax liability shown on the taxpayer's return for the preceding tax year. The taxpayer's preceding tax year must have been for a period of twelve (12) months. "Tax liability shown on the taxpayer's return" means total tax, as reported, less business and incentive credits.

26-18-306 REFUND AND CREDIT CLAIMS

1.26-18-306(i)(1) Claims for a Refund or Credit

A verified claim for an income tax credit or refund may be submitted on an amended return (AR1100CTX) or on the taxpayer's letterhead as set forth in 1.26-18-507(a). Upon request by the Department, it shall be the burden of the taxpayer to prove that all claimed prior income tax payments that are reflected on an amended return or verified claim for credit or refund were made.

The Department will accept legible copies of the front and back of canceled checks as proof of prior payments. Where the taxpayer paid the tax at issue via Electronic Funds Transfer ("EFT"), documentation from the taxpayer's bank will be necessary to establish proof of payment.

26-18-404 TAXPAYER RELIEF

1.26-18-404 Protesting Proposed Assessments

A taxpayer may file a protest based upon a Notice of Tax Adjustment and need not wait until a Notice of Proposed Assessment is received.

Taxpayers must protest a Notice of Proposed Assessment in writing, within thirty (30) days of service of the notice. The

protest must include the taxpayer's grounds for protesting the assessment. The grounds should be explained as thoroughly as possible to enable the Department to better understand the taxpayer's position. If the thirtieth (30th) day falls on a Saturday, Sunday or legal holiday, the next succeeding day which is not a Saturday, Sunday or legal holiday is considered to be the thirtieth (30th) day for purposes of meeting the prescribed time period in which to file the protest.

26-18-406 TAXPAYER RELIEF

1.26-18-406 Administrative and Judicial Review

Taxpayers who receive a Notice of Proposed Assessment or Notice of Proposed Disallowance of a Claim for Refund may obtain an administrative review of the matter by the Department's Office of Hearings and Appeals as set forth in ACA 26-18-404. If the taxpayer is not satisfied with the decision issued by the Office of Hearings and Appeals, the taxpayer may request a further review of the matter by the Department's Commissioner of Revenue as set forth in ACA 26-18-405(d)(4).

Taxpayers have the option of bypassing administrative review by the Department altogether by taking the disputed assessment or refund claim directly to Chancery Court. When a taxpayer chooses to bypass the administrative review process, the following procedure shall apply with respect to a **Notice of Proposed Assessment**:

- A. The taxpayer should not protest the Notice of Proposed Assessment within the thirty (30) day period following receipt of the notice (see ACA 26-18-404(c));
- B. A Notice of Final Assessment will be issued by the Department soon after the expiration of the thirty (30) day period (see ACA 26-18-403(a)(2));
- C. Within one (1) year from the issue date of the Notice of Final Assessment, the taxpayer must pay the entire amount of tax due for at least one tax period covered by the final assessment. A tax "period" is equivalent to any one (1) tax year (full or short) for which an Arkansas corporation income tax return must be filed. **Taxpayers who pay only part of an assessment should be aware that the Department may proceed with collection activities, including the filing of liens as authorized under ACA 26-18-701, within thirty (30) days of the issuance of the final assessment, for any assessed, but unpaid taxes, penalties or interest owed by the taxpayer for**

all remaining tax periods covered by the final assessment;

- D. Within one (1) year from the date of the taxpayer's full or partial payment as addressed above, the taxpayer must file its lawsuit with the Pulaski County Chancery Court or the Chancery Court of the county in which the taxpayer has its principal place of business;
- E. If the taxpayer has already made its full or partial payment of the assessment **before** the Notice of Final Assessment is actually issued, the taxpayer shall then have one (1) year from the date the Notice of Final Assessment is eventually issued within which to file its lawsuit.

When a taxpayer chooses to bypass the administrative review process, the following procedure shall apply with respect to a **Notice of Proposed Disallowance of a Claim for Refund:**

- A. The taxpayer should not protest the Notice of Proposed Disallowance of a Claim for Refund within the thirty (30) day period following receipt of the notice (see ACA 26-18-404(c));
- B. A Notice of Final Disallowance of a Claim for Refund will be issued by the Department soon after the expiration of the thirty (30) day period (see ACA 26-18-507(e)(2)(C));
- C. Within one (1) year from the issue date of the Notice of Final Disallowance of a Claim for Refund, the taxpayer must file its lawsuit with the Pulaski County Chancery Court or the Chancery Court of the county in which the taxpayer has its principal place of business.

26-18-505 EXTENSION OF TIME FOR FILING RETURNS

1.26-18-505(a)(3)(A) First Ninety Day State Extension

Taxpayers may request a ninety (90) day "state" extension for filing the Arkansas corporation income tax return from the Corporate Income Tax Section. This request shall be made in writing and on or before the original due date of the return or, if applicable, the due date for the federal return as extended by the IRS's six month automatic extension. Upon receipt by the Department, the extension request will be approved or disapproved and a confirmation will be sent back to the taxpayer. If approved, the confirmation must be attached to the return when filed. An approved extension only extends the filing due date

and does not extend the due date for payment of any income tax due. If any tax due is reflected on the filed return but was not paid on or before the original due date, interest at the rate of 10% per annum will be assessed from the original due date until the tax is paid. Likewise, a failure to pay penalty under ACA 26-18-208(2)(A) will apply to any tax not paid on or before the extended due date. **Refer to 1.26-51-807 and 2.26-51-807 for important related information on "federal" extensions of time.**

Any federal extensions that have been taken should be applied first; Arkansas (that is, state) extensions should be applied after any federally granted extensions.

Example (without a federal extension):

Calendar year ending 12/31/93, therefore Arkansas return's original due date is 05/15/94. Arkansas extension request must be filed on or before 05/15/94 on Arkansas Form AR1055, stating the reason for the request. If a 90 day extension is granted, the Arkansas return must be filed on or before 08/15/94.

1.26-18-505(a)(3)(B) Second Ninety Day State Extension

The director may issue a second ninety (90) day "state" extension for extraordinary circumstances. **This additional extension will run consecutively with the first extension.** This request shall be made on or before the expiration of the first ninety (90) day extended due date. **Refer to 1.26-51-807 and 2.26-51-807 for important related information on "federal" extensions of time.**

Any federal extensions that have been taken should be applied first; Arkansas (that is, state) extensions should be applied after any federally granted extensions.

Example (without a federal extension):

Calendar year ending 12/31/93 with an approved Arkansas ninety (90) day extension. If the taxpayer requested an additional extension of 60 days, the request must be filed on or before 08/15/94 (the Arkansas income tax return's original due date of 05/15/94, plus the first 90 day extension). If the additional 60 day extension is approved, the Arkansas return must be filed on or before 10/15/94 (first Arkansas extended due date of 08/15/94, plus the additional 60 day extension).

26-18-507 REFUNDS OF OVERPAYMENTS

1.26-18-507(a) Refund Claims

A verified claim for a refund of an overpayment of income tax must be filed on a corporation income tax amended return, Form AR1100CTX. In lieu of filing an amended return, a verified claim for a refund of an overpayment of income tax may be filed on the

taxpayer's letterhead, provided the following information is contained in the verified claim:

1. The federal employer identification number (FEIN) of the taxpayer;
2. The name of the taxpayer;
3. The address of the taxpayer (street or P. O. box, city, state and zip code);
4. The tax year end (month, day and year) of the original return for which the verified claim is filed;
5. A schedule detailing the original reported, net change and corrected amounts for the following figures:
 - a. total income,
 - b. total deductions,
 - c. net operating loss,
 - d. taxable income,
 - e. tax,
 - f. estimated tax paid,
 - g. business and incentive tax credits,
 - h. tax paid with original return,
 - i. amount of overpayment;
6. Grounds upon which the refund is claimed;
7. The verified claim must be signed by an authorized officer or agent of the taxpayer. An agent must attach an executed power of attorney issued by an authorized officer of the taxpayer;
8. Any other information relative to the payment as may be required by the Department.

26-51-102 CORPORATION INCOME TAX DEFINITIONS

1.26-51-102(5) Characteristics of Corporations

The term "corporation" refers to an organization whose characteristics require it to be classified for purposes of taxation as a corporation rather than as another type of organization such as a partnership or a trust. There are a number of characteristics ordinarily found in a corporation which, when taken together, distinguish it from other organizations. These are: (i) associates, (ii) an objective to carry on business and divide the gains therefrom, (iii) continuity of life, (iv) centralization of management, (v) liability for corporate debts limited to corporate property, and (vi) free transferability of interests. Whether a particular organization is to be classified as a corporation must be determined by taking into account the presence or absence of each of these corporate characteristics. Other factors may be found in some cases which may be significant in classifying an organization as a corporation, a partnership, or a trust. An organization will be treated as a corporation if the corporate characteristics are such that the organization more nearly resembles a corporation than a partnership or trust.

1.26-51-102(7) Foreign Corporation

A foreign corporation or association or partnership is one organized under the laws of any other state or country, whether or not its principal place of business is located within the State of Arkansas.

1.26-51-102(8) Fiduciary

A fiduciary is an individual or corporate guardian, trustee, executor, administrator, receiver or conservator acting in any fiduciary capacity for any person, trust, estate or business entity. A fiduciary relationship is considered one of trust and confidence. A fiduciary has a legal responsibility to act in the beneficiary's best interest.

1.26-51-102(17)(A) Tax Year

Tax year means the calendar year or fiscal year upon which taxable income is computed. A calendar year means a period of 12 months ending on December 31. A fiscal year means a period of 12 months ending on the last day of any month other than December.

A tax return for the period 01/01/93 through 12/31/93 is a calendar year return and is referred to as the 1993 tax year. Any correspondence or assessments from the Department concerning this tax year will be designated as the tax year ending 12/93 or as tax year 1993.

A tax return for the period 02/01/92 through 01/31/93 is a fiscal year return and is also considered a 1993 tax year return. Any correspondence or assessments from the Department will be designated as the tax year ending 01/93, or as tax year 1993.

2.26-51-102(17)(A) Tax Year

A taxpayer may elect to compute his taxable income on the basis of an annual period which varies from 52 or 53 weeks. A 52 or 53 week tax year means the annual period which varies from 52 or 53 weeks and always ends on the same day of the week and always ends:

- (1) on whatever date such same day of the week last occurs in a calendar month; or
- (2) on whatever date such same day of the week falls which is nearest to the last day of a calendar month.

For example, if the taxpayer elects a tax year which always ends on the last Saturday in November, then for the year 1994, the tax year would end on November 26, 1994. On the other hand, if the taxpayer had elected a tax year which always ends on the Saturday nearest to the end of November, then for the year 1994, the tax year would end on December 3, 1994. Thus, in the case of a tax year described in subparagraph (1) of this regulation, the year

will always end within the month and may end on the last day of the month, or as many as six days before the end of the month.

In the case of a tax year described in subparagraph (2) of this regulation, the year may end on the last day of the month, or as many as three days before or three days after the last day of the month.

For the purpose of determining the effective date or the applicability of any corporate income tax statute which is expressed in terms of tax years beginning, including, or ending on the first or last day of a specified calendar month, a 52 or 53 week tax year is deemed to begin on the first day of the calendar month beginning nearest to the first day of the 52 or 53 week tax year, and is deemed to end or close on the last day of the calendar month ending nearest to the last day of the 52 or 53 week tax year. This is illustrated by the following examples:

Example (1). Assume that an income tax provision applies to tax years beginning on or after January 1, 1994. For that purpose, a 52 or 53 week tax year beginning on any day within the period December 26, 1993, to January 1, 1994, shall be treated as beginning on January 1, 1994.

Example (2). Assume that an income tax provision requires that a return must be filed on or before the 15th day of the fifth month following the close of the tax year. For that purpose, a 52 or 53 week tax year ending on any day during the period May 25 to June 3, shall be treated as ending on May 31, the last day of the month ending nearest to the last day of the tax year, and the return, therefore, must be made on or before October 15.

Example (3). X, a corporation created on January 1, 1994, elects a 52 or 53 week tax year ending on the Friday nearest the end of December. Thus, X's first tax year begins on Saturday, January 1, 1994, and ends on Friday, December 30, 1994; its next tax year begins on Saturday, December 31, 1994, and ends on Friday, December 29, 1995; and its next tax year begins on Saturday, December 30, 1995, and ends on Friday, January 3, 1997. X's first tax year is deemed to begin on January 1, 1994, and end on December 31, 1994; its next tax year is deemed to begin on January 1, 1995, and end on December 31, 1995. Accordingly, each such tax year is treated as including one and only one December 31st.

1.26-51-102(17)(B) Tax Year

A fractional part of a year (short tax year) means a period of less than twelve (12) months. If a short tax year ends on or before the 15th day of the month, then the short tax year shall be deemed to have ended on the last day of the previous month.

If a short tax year ends on or after the 16th of the month, then the short tax year shall be deemed to have ended on the last day of the current month.

Note: A taxpayer must calculate its Arkansas income tax liability using the same tax year for Arkansas income tax purposes as used for federal income tax purposes.

2.26-51-102(17)(B) Carryforwards for Short Years

Tax years for a fractional part of a year will be counted as a full tax year for carryforward of net operating losses and tax credits unless otherwise specified by law.

26-51-204 RAILROADS AND PUBLIC UTILITIES

1.26-51-204 Railroads

Every organization operating a railroad, partly within and partly without the state, shall apportion the net operating income attributable to this state by multiplying the net income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor doubled and the denominator of which is four.

Property factor - The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period; provided, that the average value of the operating equipment (locomotives, freight and passenger cars, work and miscellaneous equipment) shall be apportioned to the state in the ratio of total miles such property is operated within the state to total miles operated throughout the system.

Average value of the property owned by the taxpayer means the average of the original cost of the property at the beginning and ending of the tax period. Property rented is valued at eight times the net annual rental.

Payroll factor - The payroll factor is a fraction, the numerator of which is compensation paid for services performed entirely within the state plus a proportionate part of the compensation paid for services performed both within and without the State based on the ratio of total miles traveled within the state to total miles traveled, and the denominator of which is total compensation paid during the tax period.

Sales factor - The sales factor is a fraction, the numerator of which is the gross revenue from within the state plus a proportionate part of interstate revenues earned in the state determined on the basis of miles operated in the state to total miles operated in the system and the denominator of which is total operating revenues.

To the net income thus determined shall be added nonoperating revenues from sources within Arkansas less any related expenses.

"Operating" income is the same as "business" income.
 "Nonoperating" income is the same as "nonbusiness" income.

Example: ABC Railroad

A.	Average Property in Arkansas	\$1,000,000
B.	Average Property in Texas	\$1,000,000
C.	Average Locomotives & Equipment	\$1,000,000
D.	Operating Miles in Arkansas	400,000
E.	Operating Miles in Texas	600,000
F.	Payroll in Arkansas	\$200,000
G.	Payroll in Texas	\$200,000
H.	Interstate Payroll	\$100,000
I.	Arkansas Revenues	\$1,000,000
J.	Texas Revenues	\$1,000,000
K.	Interstate Revenues	\$500,000
L.	Arkansas Non-business Revenues	\$150,000
M.	Related Expenses	\$20,000
N.	Total Non-business Revenues	\$500,000
O.	Related Expenses	\$50,000
Federal Return:		
P.	Total Income	\$3,000,000
Q.	Total Deductions	\$2,000,000
R.	Line 28 Income	\$1,000,000

The Arkansas property factor is the average value of real and tangible property in Arkansas, plus the average value of interstate property, multiplied by Arkansas' total miles, divided by total miles, divided by average value of all property or:

$$A + (D \div [D + E] \times C) \div (A + B + C) = \text{Property Factor}$$

$$\begin{aligned} & \$1,000,000 + (400,000 \text{ mi} \div [400,000 \text{ mi} + 600,000 \text{ mi}] \times \\ & \$1,000,000) \div (\$1,000,000 + \$1,000,000 + \$1,000,000) = 46.666667\% \end{aligned}$$

The Arkansas payroll factor is Arkansas payroll, plus interstate payroll, multiplied by Arkansas total miles, divided by total miles, divided by total payroll or:

$$F + (D \div [D + E] \times H) \div (F + G + H) = \text{Payroll Factor}$$

$$\begin{aligned} & \$200,000 + (400,000 \text{ mi} \div [400,000 \text{ mi} + 600,000 \text{ mi}] \times \\ & \$100,000) \div (\$200,000 + \$200,000 + \$100,000) = 48.000000\% \end{aligned}$$

The sales factor is Arkansas revenues, plus interstate revenues, multiplied by Arkansas total miles, divided by total miles, divided by total revenues or:

$$I + (D \div [D + E] \times K) \div (I + J + K) = \text{Sales Factor}$$

$$\begin{aligned} & \$1,000,000 + (400,000 \text{ mi} \div [400,000 \text{ mi} + 600,000 \text{ mi}] \times \$500,000) \\ & \div (\$1,000,000 + \$1,000,000 + \$500,000) = 48.000000\% \times 2 = \\ & 96.0000\% \text{ (due to double weighted sales factor)} \end{aligned}$$

Arkansas apportionable income is Line 28 federal taxable income less net non-business income or:

$$R - (N - O) = \text{Arkansas Apportionable Income}$$

$$\$1,000,000 - (\$500,000 - \$50,000) = \$550,000$$

This is assuming no other adjustments are necessary.

The Arkansas apportionment factor is the property factor, plus the payroll factor, plus the sales factor, divided by four(4).

Example:

$$(46.666667\% + 48.000000\% + 96.000000\%) \div 4 = 47.666667\%$$

Income apportioned to Arkansas is \$550,000 x 47.666667% or \$262,167. Direct income allocated to Arkansas is \$150,000 minus \$20,000 or \$130,000, Arkansas taxable income is \$392,167.

2.26-51-204 Private Railcar Operators

Every taxpayer, other than a railroad, engaged in the business of operating railcars or in the business of furnishing or leasing railcars, by whatever name known, for the transportation of freight or property whether or not owned by such taxpayer, over any railway lines partly within and partly without the state, shall determine the net income subject to tax by taking that portion of total net operating income that the total miles operated in the state bears to total system miles operated.

Example: A corporation which is a private railcar owner had \$200,000 federal taxable income, and operated 2,000,000 total miles in Arkansas and 20,000,000 miles everywhere. The apportionment factor is 10.000000% and Arkansas taxable income is \$20,000, assuming no adjustments to federal taxable income are required.

Miles in Arkansas	2,000,000
Miles in Tennessee	<u>18,000,000</u>
Total System Miles	20,000,000
Operating Income	\$1,000,000

Operating Expenses	800,000
Total Net Operating Income	\$ 200,000

$(2,000,000 \div 20,000,000) \times \$200,000 = \$20,000$

3.26-51-204 Public Utilities

Telephone, electric power and gas distribution companies operating both inside and outside of Arkansas shall allocate and apportion to Arkansas their net income by use of the allocation and apportionment procedures provided under UDITPA (Uniform Division of Income for Tax Purposes Act). UDITPA (ACA 26-51-701 et seq.) applies to all taxpayers doing business both inside and outside of Arkansas.

26-51-205 CORPORATION INCOME TAX RATES

1.26-51-205 Income Tax Rates

Every domestic and foreign corporation doing business within Arkansas shall pay a graduated income tax on its entire Arkansas net taxable income based on the following tax rate:

first \$3,000 of net income	-- 1.0%
second 3,000 of net income	-- 2.0%
next 5,000 of net income	-- 3.0%
next 14,000 of net income	-- 5.0%
next 75,000 of net income	-- 6.0%
over 100,000 of net income	-- 6.5%

Note: A tax table is provided in each Corporation Income Tax Booklet and should be used in determining the tax.

Examples:

(1) \$25,000 through \$100,000 Tax is \$940 plus 6% of excess over \$25,000.

Arkansas Net Taxable Income	\$75,000
Tax on 1st \$25,000 (Per Tax Table)	\$ 940
Tax on next \$50,000 (\$50,000 x 6%)	3,000
Total Tax	\$3,940

(2) Over \$100,000 Tax is \$5,440 plus 6.5% of the excess over \$100,000.

Arkansas Net Taxable Income	\$110,000
Tax on 1st \$100,000 (Per Tax Table)	\$5,440
Tax on next \$10,000 (\$10,000 x 6.5%)	650
Total Tax	\$6,090

26-51-303 EXEMPT ORGANIZATIONS

1.26-51-303 Definitions and Guidelines for Claiming Tax-Exempt Status

"Corporation" shall mean an entity operating under articles of incorporation, being properly registered with Arkansas, and meeting the requirements of Section 303 for recognition of tax exempt status.

"Trust" shall mean an entity operating under a trust indenture or agreement.

A "cooperative association" is a group of individuals formed to participate in a productive enterprise, the profits being shared in accordance with the capital or labor contributed by each.

A "partnership" includes a syndicate, group, joint venture or other unincorporated organization operating under the terms and conditions of a partnership agreement.

"Association" shall mean an entity operating under articles of association, a constitution or other creating documents with a declaration or other evidence the organization was formed by adoption of the document by more than one person and having by-laws.

"Unrelated income" shall mean any income earned from activities carried on by the organization which is not substantially related to its exempt purposes.

"IRS Ruling Letter" shall mean an official notification by the Internal Revenue Service of acceptance of tax-exempt status of the organization.

Nonprofit corporations, unincorporated groups or associations and trusts shall be eligible to receive income tax-exempt status under ACA 26-51-303 or ACA 26-51-309 upon submitting proper documentation and application to the Arkansas Revenue Division, Corporation Income Tax Section, P.O. Box 919, Little Rock, Arkansas 72203-0919. The following information must be submitted for a determination of state income tax-exempt status:

A. Organizations with an IRS Ruling letter:

1. Copy of IRS Ruling letter;
2. Copy of pages 1 and 2 of IRS form 1023 or 1024;
3. Statement declaring Arkansas Code under which exempt.

B. Organizations without an IRS Ruling letter:

1. Arkansas form AR1023CT;
2. Copy of Articles of Incorporation, Articles of Association, Trust Indenture or Agreement;
3. Copy of By-laws.

Act 1147 of 1993, known as the Non-profit Corporation Act of 1993, adopted section 664 of the Internal Revenue Code as in effect on January 1, 1993, for the purpose of computing the tax liability of charitable remainder trusts and their beneficiaries. See ACA 26-51-309.

Any unrelated income of a nonprofit corporation operating in Arkansas as well as in other states shall be reported to the state in which it is earned. Any unrelated income attributable to Arkansas would be subject to Arkansas income tax.

Revocation of tax-exempt status shall be effective on the same date as the Internal Revenue Service revocation (if made) or upon notification to the taxpayer by the Arkansas Revenue Division upon investigation and discovery of sufficient grounds for revocation. Sufficient grounds for revocation shall mean any investigation in which it is determined that the organization is not operating in the manner under which it originally obtained exempt status.

26-51-401 ACCOUNTING METHODS

1.26-51-401(a) Accounting and Recordkeeping Requirements

Arkansas taxpayers must use the same accounting method as that used for federal income tax purposes.

Each taxpayer is required by Arkansas law to file an income tax return reflecting its true and correct income. Therefore, adequate accounting records and source documents must be retained to justify that the filed income tax returns are a true and correct accounting of the taxpayer's transactions for each tax year. As a general rule, the accounting records and source documents should be retained for a minimum of six (6) years after the return that such records support has been filed.

Essential accounting requirements are as follows:

(1) In all cases in which the production, purchase or sale of merchandise of any kind is an income-producing factor, inventories of the merchandise on hand (including finished goods, work in process, raw materials, and supplies) should be taken at the beginning and end of the year and used in computing the net income for the tax year;

(2) Expenditures made during the tax year should be properly classified as between capital and expense. Expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the tax year should be charged to a capital account and not to an expense account; and

(3) In any case in which the cost of capital assets is being recovered through deductions for wear and tear, depletion or obsolescence, any expenditure (other than ordinary repairs) made to restore the property or prolong its useful life should be added to the property account or charged against the appropriate reserve and not to current expenses.

2.26-51-401(a) Accounting Requirements

Only those methods of accounting which clearly indicate the taxpayer's income will be accepted. All items of gross income and all deductions must be treated with reasonable consistency.

All items of gross income subject to taxation shall be included in gross income **for the tax year in which they are received by the taxpayer**, unless in order to clearly reflect income such amounts are to be properly accounted for as of a different period. See ACA 26-51-404(a)(2). For instance, in a case where it is necessary to use an inventory, no other accounting method with respect to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. On the other hand, appreciation in value of property is not an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property.

1.26-51-401(b) Change in Accounting Methods

If for any reason the method of reporting income subject to tax is changed, the taxpayer shall attach to his income tax return a copy of the Internal Revenue Service certification or approval of the change in accounting method.

26-51-402 BASIS FOR DETERMINING TAX LIABILITY

1.26-51-402(a) Tax Year

No income tax return can be made for a period of more than twelve months, unless the return is based on a 52 or 53 week tax year.

A separate income tax return for a fractional part of a year is therefore required whenever there is a change (with the approval of the Director) in the basis of computing net income from one tax year to another tax year. The requirements for filing a separate income tax return and payment of tax for a part of a tax year are the same as for the filing of an income tax return and the payment of tax for a full tax year closing at the same time.

The tax on net income computed for the period for which a

separate income tax return is made shall be computed at the rate for the tax year in which such period is included. **Arkansas taxpayers must use the same tax year as that used on the federal income tax return.**

26-51-404 GROSS INCOME GENERALLY

1.26-51-404(a)(1) Definitions

Corporation income tax is imposed upon net income. In the computation of the tax, various classes of income must be considered.

- (a) "Gross Income" means all income which flows to the taxpayer, other than a return of capital, and includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. Many factors must be taken into consideration in accurately determining gross income, among which are inventories, accounts receivable, property exhaustion, accounts payable for expenses incurred and exemptions as allowed by Arkansas law.
- (b) "Net income" is gross income less statutory deductions. The statutory deductions are generally, though not exclusively, expenditures (other than capital expenditures) connected with the production of income.

2.26-51-404(a)(1) Receipt of Income

Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by it at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case, the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to the taxpayer so that it may be drawn upon at any time. The income must be brought within the taxpayer's own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. Where a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt.

3.26-51-404(a)(1) Manufacturing, Merchandising and Mining

In the case of a manufacturing, merchandising or mining business, "gross income" means the total sales less the cost of goods sold, plus any income from investments and from incidental or outside

operations or sources. In determining the gross income, subtractions should not be made for depreciation, depletion, selling expenses, losses or for items not ordinarily allowable in computing the cost of goods sold.

4.26-51-404(a)(1) Contract with U.S. Government

The income of an independent contractor from a contract with the United States Government must be included in gross income.

5.26-51-404(a)(1) Payment in Forms Other than Cash

Where services are paid for with something other than money, the fair market value for the item taken in payment is the amount to be included as income. Unless there is evidence to the contrary, services rendered at a stipulated price will be presumed to be the fair market value of the compensation received.

Compensation paid to an employee of a corporation in the corporation's own stock is to be treated as if the corporation sold the stock for its fair market value and then paid the employee in cash.

6.26-51-404(a)(1) Promissory Notes

Notes or other evidence of indebtedness, received as payment for goods or services or other types of income and not merely as security for such payment, constitute income to the amount of their fair market value. Such notes not bearing interest shall be discounted at the fair market rate and the discounted value recognized as income at the time of receipt. The amount of the discount of such notes is amortized and recognized as income when received by the taxpayer.

7.26-51-404(a)(1) Leased Property

Rents received by a lessor corporation which are based on a rate of dividend or interest on capital stock or outstanding indebtedness, including any fixed tax or insurance payments, shall be reported by the lessor corporation as rental income.

8.26-51-404(a)(1) Sale of Stock Shares

The proceeds from the sale by a corporation of its capital stock, either through original issue or secondary transactions, whether in excess of or less than par value or purchase cost, constitute a capital transaction of the company and will not produce taxable income nor a deductible loss for the corporation.

9.26-51-404(a)(1) Corporate Bonds

When bonds are originally issued by a corporation at a fair market value which results in a premium or a discount compared to face value, the premium (income) or discount (expense) should be

prorated or amortized over the life of the bonds.

When a corporation purchases and retires any of its bonds at a fair market price greater than or less than the issuing price, the amount of the purchase price over the issue price (excess amount) is a deductible expense for the tax year or the amount of the issue price over the purchase price (lesser amount) is income for the tax year. The deductible excess amount is reduced by any previously amortized issue discount or increased by any previously amortized issue premium of the bonds. The taxable lesser amount is increased by any previously amortized issue discount or reduced by any previously amortized issue premium.

10.26-51-404(a)(1) Farming

The term "farm" is to be interpreted in its ordinary, accepted sense. A farm is used to produce agricultural products such as livestock (including fish), dairy products, crops, fruits and nuts. A taxpayer engaged in forestry or the growing of timber or trees is not engaged in farming. A person cultivating or operating a farm for recreation or pleasure rather than a profit is not engaged in the business of farming. See IRC Regulations §1.61-4(d) and §1.175-3.

11.26-51-404(a)(1) Sale of Property

When property is acquired and later sold for an amount in excess of the cost or other basis, the gain on the sale is income. When a taxpayer sells its capital assets in whole or in part, it shall include in its gross income for the tax year in which the sale was made the gain from such sale computed as provided in ACA 26-51-411 through ACA 26-51-413. If the purchaser takes possession of the assets and assumes the liability, then the amount so assumed is part of the selling price.

12.26-51-404(a)(1) Corporate Dissolution

When a corporation is dissolved, its affairs are usually settled by a receiver or trustee in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and the receiver or trustee may act for the corporation for such purposes. Any sale of property by them is to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the distribution of its assets in a partial or complete liquidation, even though the assets may have appreciated or depreciated in value since their acquisition.

13.26-51-404(a)(1) Voluntary Shareholder Payments

Where a corporation requires additional funds for conducting its business and obtains such funds through voluntary pro rata payments by its shareholders and the amount so received is credited to its surplus account or to a special capital account,

such amounts will not be considered income, even though there is no increase in the outstanding shares of stock of the corporation. The payments in such circumstances are in the nature of voluntary assessments that represent an additional price paid for the shares of stock held by the individual shareholder, and will be considered as an addition to and a part of the operating capital of the company.

14.26-51-404(a)(1) Trusts

If a corporation, for the purpose of ensuring payment of its bonds or other indebtedness, places property in trust or sets aside certain amounts in a sinking fund under the control of a trustee who may be authorized to invest and reinvest such sums from time to time, the property or fund thus set aside by the corporation and held by the trustee is an asset of the corporation and any gain arising therefrom is income of the corporation and shall be included as such in its gross income.

15.26-51-404(a)(1) Annuities

Amounts received as an annuity are subject to tax except receipts which are considered to represent a reduction or return of consideration paid. The proportionate part of each annuity payment which is excludable from gross income is a fraction. The numerator is the investment in the contract on the annuity starting date. The denominator is the expected return under the contract on that date. Investment in the contract is the total amount paid, less amounts received prior to the annuity starting date which were not included in gross income. The annuity starting date is the later of the first day a benefit payment is received under the annuity contract, or the fixed date in the contract.

Example: Brown received \$10,000.00 on a 10-year endowment contract which matured in 1993. He had paid premiums of \$8,500.00 and had received dividends of \$200.00 before the contract matured. Brown's cost to be recovered tax free is \$8,300.00 (\$8,500.00 minus \$200.00). If payments are received in installments, 83% of each payment ($8,300 \div 10,000$) will be a nontaxable return of consideration paid and the remaining 17% will be taxable.

16.26-51-404(a)(1) Real Estate

Where a tract of land is purchased with the intent of selling subdivided lots or parcels, the cost or other basis shall be equitably apportioned to the several lots or parcels and made a matter of record on the books of the taxpayer. To the extent that any gain derived from the sale of any such lots or parcels constitutes taxable income, it may be reported as income for the tax year in which the sale is made. This rule contemplates that there must be a measure of gain or loss on every lot or parcel sold, and not measured on the entire tract as a whole. The sale

of each lot or parcel must be treated as a separate transaction and gain or loss computed accordingly.

17.26-51-404(a)(1) Lease of Buildings

When buildings are erected or improvements made by a lessee pursuant to an agreement with the lessor and such buildings or improvements are not subject to removal by the lessee, the lessor may report the income therefrom upon either of the following bases:

- (a) The lessor may report as income, at the time when such buildings or improvements are completed, the fair market value of such buildings or improvements subject to the lease; or
- (b) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the termination of the lease and report as income for each tax year of the lease an allocated part thereof.

If the lease is terminated and the lessor comes into possession or control of the property prior to the time originally fixed for the termination of the lease, the lessor receives additional income for the tax year in which the lease is so terminated to the extent that the value of such buildings or improvements exceeds the amount already reported as income on account of the erection of such buildings or improvements. No appreciation in value due to causes other than the premature termination of the lease shall be included. Conversely, if the buildings or improvements are destroyed prior to the expiration of the lease, the lessor is entitled to deduct as a loss for the tax year when such destruction takes place the amount previously reported as income because of the erection of such buildings or improvements, less any salvage value and only to the extent that such loss was not compensated for by insurance.

18.26-51-404(a)(1) Long-Term Contracts

Income from long-term contracts is taxable for the period in which the income is generated. The determination of taxable income is dependent upon the nature and terms of the contract.

Arkansas taxpayers must use the same accounting method as that used for federal income tax purposes.

"Long-term" contracts are contracts which will take more than one (1) year to be fully and completely performed.

19.26-51-404(a)(1) Stock Distributions

The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders. However, any gain derived from the sale of such

stock by the shareholders is taxable to the shareholders. Distributions received by shareholders from regulated investment companies are, by reason of the shareholder's option to receive the equivalent of cash or new stock, deemed to be a cash dividend and are therefore taxable.

1.26-51-404(a)(2) Receipt of Income

All items of gross income received by a taxpayer must be included in the taxpayer's gross income for the tax year in which such items were received.

2.26-51-404(a)(2) Installment Sales of Personal Property

Dealers who sell personal property on an installment plan must include all installment payments received during any given tax year in the dealer's gross income for such tax year. The income from installment sales cannot be reported evenly over the life of the installment contract when payments are accelerated or delayed compared to the contractual amortization. A dealer is one who is engaged in buying and selling personal property of the same type or real estate as his principal business. For treatment of gain or loss on such sales, see 1.26-51-411(e).

3.26-51-404(a)(2) Installment Sales of Real Estate

A taxpayer who sells real estate on an installment plan must include all installment payments received during any given tax year in the taxpayer's gross income for such tax year. The income from installment sales cannot be reported evenly over the life of the installment contract when payments are accelerated or delayed compared to the contractual amortization.

**1.26-51-404(b)(1) Gain on Compulsorily or Involuntarily
Converted Property**

Section 1033 of the Internal Revenue Code of 1986, as in effect on January 1, 1997 relating to the exclusion from gross income of gain resulting from the involuntary conversion of a taxpayer's property, has been adopted for the purpose of computing Arkansas income tax liability. Refer to Treasury Regulations §1.1033(a)-1 et seq. for guidance on such matters.

1.26-51-404(b)(3) Life Insurance Proceeds

Proceeds of life insurance policies paid by reason of death of the insured to his/her estate or any beneficiary either in a lump sum or otherwise, except a transferee for valuable consideration, is excluded from the gross income of the beneficiary. Interest paid on the proceeds is included in gross income.

Transferees for valuable consideration and recipients, paid due to reasons other than insured death, of life insurance, endowment, or annuity contracts include in gross income the

proceeds and interest that are in excess of the total consideration, premiums, and other sums paid to obtain the contract.

1.26-51-404(b)(6) Interest on U.S. Government Obligations

Interest earned on obligations of the United States or its possessions is not included in gross income.

"Obligations of the United States" means any U.S. Government obligation used to finance the national debt, such as U.S. Treasury bills, savings bonds or any other instrument acknowledged by the U.S. Secretary of the Treasury as an obligation of the United States.

These obligations must be specifically exempt from state taxation by federal law **or** must meet the four criteria established by Smith v. Davis, 323 U.S. 111, 89 L Ed 107, 65 S Ct 157 (1944).

The requirements are that the obligations must:

- 1) be in writing;
- 2) bear specific interest;
- 3) bind the U.S. to pay specific sums at specific dates, and;
- 4) have congressional authority to pledge the full faith and credit of the United States in support of the promise to pay.

For example, interest received from the Federal National Mortgage, Government National Mortgage and Federal Home Loan Mortgage Corporation do not meet all four of the above stated requirements and therefore is not tax exempt. This is not intended to be an all inclusive list.

2.26-51-404(b)(6) Interest on State of Arkansas Obligations

Interest earned on obligations of the State of Arkansas or any political subdivision thereof is not included in gross income.

"Obligations of the State of Arkansas" means any obligation backed by credit of the State of Arkansas.

"Any political subdivision" means a county, city or town, including special assessment districts such as road, water, sewer, reclamation, drainage, levee, school or similar districts.

1.26-51-404(b)(11) Cancellation or Forgiveness of Indebtedness

The cancellation and forgiveness of indebtedness may amount to a payment of income, a gift or a capital transaction, depending upon the circumstances. If, for example, an individual performs services for a creditor in exchange for cancellation of a debt,

income equal to the debt is realized by the debtor as compensation for his services. If, however, a creditor merely desires to benefit a debtor, and, without any consideration therefore, cancels the debt, the amount of the debt is a gift from the creditor to the debtor and need not be included in the debtor's gross income. If a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation.

26-51-411 GAIN OR LOSS - SALES OF PROPERTY

1.26-51-411 Amount Realized on Sale of Property

The amount realized from the sale or other disposition of property is the sum of any money received plus the fair market value of any property (other than money) received. The fair market value of property is a question of fact, but only in rare and extraordinary cases does property have no fair market value.

In computing the amount of gain or loss, the cost or other basis of the property sold shall be adjusted for items properly chargeable to the seller's capital account. Adjustments include expenditures (such as to maintain effective usefulness), losses, improvements, carrying charges (such as taxes) on nonproductive property, and deductions for exhaustion, wear and tear, obsolescence and depletion.

Any carrying charges deducted to compute taxable income will not be used to increase basis. Deductions allowable since the acquisition of the property, **whether or not actually claimed by the taxpayer or formally allowed**, will be used to adjust basis. Reduction in basis due to depletion shall not exceed such a deduction computed without reference to discovery for mines, oil and gas wells. The basis of stock shares must be reduced by the amount of previous distributions made as returns of capital.

2.26-51-411 Sale of Shares of Stock

When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost or other basis of the stock will constitute gain.

When a dividend is paid with the stock of the dividend payor, the basis for determining gain or loss from the sale of shares of such stock shall be the difference between the sale price and the quotient (or result) of the cost or other basis of the original shares of stock divided by the total number of the old and new shares.

When common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities. However, should that not be feasible, no profit on any subsequent sale of any part of the stock or securities will be realized until the total cost is recovered from the sale proceeds.

When a corporation issues to its shareholders rights to subscribe to its stock, the value of the rights do not constitute taxable income to a shareholder, although gain may be derived or loss sustained by a shareholder from the sale of such rights. The following rules shall apply:

(1) If the shareholder does not exercise, but rather sells his rights to subscribe, the cost or other basis of the stock with respect to which the rights are issued shall be apportioned between the rights and the stock in proportion to their respective values at the time the rights are issued. The basis for determining gain or loss from the sale of a right or a share of such stock will be the quotient (or result) of the cost or other basis assigned to the right or the stock divided by the number of rights issued or by the number of shares held.

(2) If the shareholder exercises his rights to subscribe, the basis for determining gain or loss from a subsequent sale of a share of the stock obtained through exercising the rights shall be determined by dividing the part of the cost or other basis of the old shares assigned to the rights, including the subscription price of the new shares, by the number of new shares obtained.

(3) If the stock with respect to which the rights are issued was purchased at different times and at different prices and the identity of the lots cannot be determined, **or** if such stock was purchased at different times and at different prices and the stock rights cannot be identified as having been issued with respect to any particular lot of such stock, the basis for determining the gain or loss from the sale of:

- i. the old shares;
- ii. the rights in cases where the rights are sold; or
- iii. the old or new shares in cases where the rights are exercised,

shall be calculated by applying the cost or ascertained value of the rights from the earliest purchased stock.

The taxpayer may, at its option, include the entire proceeds from the sale of stock rights in its gross income. The basis for determining gain or loss from the subsequent sale of stock with respect to which the rights were issued shall be the same as though the rights had not been issued.

3.26-51-411 Loss Carryforwards

For corporations, all losses shall be deducted in the year in which they occur with no carryforwards except for net operating losses and those provided for by ACA 26-51-436.

1.26-51-411(e) Sales of Real Estate or Personal Property

Gain or loss on installment sales of real estate or personal property will be treated as provided in Sections 453, 453A and 453B of the Internal Revenue Code of 1986, as in effect on January 1, 1995. Refer to 1995 Treasury Regulations §1.453-4 et seq. and §1.453A-1 et seq. for guidance in applying IRC Sections 453, 453A and 453B. For proper reporting of installment payments, see 2.26-51-404(a)(2) and 3.26-51-404(a)(2).

26-51-412 GAIN OR LOSS - EXCHANGE OF PROPERTY

1.26-51-412(a) Exchange of Property for Like Property

For purposes of corporation income tax, no gain or loss shall be recognized in an exchange of property for like property of a similar value.

If property held for productive use in a trade or business or for investment is exchanged solely for property of like kind to be held either for productive use in a trade or business or for investment, no gain or loss is recognized. Such property does not include stock in trade or other property held primarily for sale, nor stocks, bonds, notes, certificates of trust, beneficial interests, other securities or evidence of indebtedness.

The words "like kind" have reference to the nature or character of the property and not its grade or quality. Therefore, no gain or loss is realized by a taxpayer, other than a dealer, from the exchange of real estate for other real estate. However, one kind or class of property may not be exchanged for property of a different kind or class, such as real estate for personal property.

A dealer is one who regularly buys and sells securities to customers in the ordinary course of business and who treats such securities as inventory.

If common or preferred stock in a corporation is exchanged solely for the same category or type of stock in the same corporation, no gain or loss shall be recognized.

If property is transferred to a corporation by one or more parties solely in exchange for stock or securities in such corporation and, immediately after the exchange, such parties are in control of the corporation, no gain or loss shall be recognized. When more than one party is involved in the transfer

to the corporation and the amount of stock and securities received by each is substantially in proportion to their interest in the property prior to the exchange, no gain or loss will be recognized.

If property is exchanged for stock and cash or other property, gain, but not loss, will be recognized to the extent of the cash or fair market value of the other property received.

2.26-51-412(a) Exchange of Property for Property Not of Like Kind

When property is exchanged for other property not of a like kind, the property received in exchange shall be treated as the equivalent of cash up to the amount of its fair market value for the purpose of determining gain or loss. If no market exists in which all of the property so received can be disposed of at the time of exchange for a reasonably certain and definite price in cash, the exchange shall be considered a conversion of assets from one form to another form and no gain or loss shall be deemed to arise. The property received in exchange shall be taken into the records of the taxpayer at the same cost or assessed value as the property which was exchanged, including additions and minus any allowable depreciation and depletion.

3.26-51-412(a) Dividends Paid in the Form of Securities or Other Property

Dividends paid in securities (other than the corporation's own stock) or other property in which the earnings of a corporation have been invested, are income to the shareholders in the amount of the market value of such property. When a corporation declares a dividend payable in the stock of another corporation, setting aside the stock to be distributed and notifying its shareholders of its action, the income attributable to the recipients of such stock is its market value at the time the dividends become payable. Scrip dividends are subject to tax in the year in which the warrants are issued.

4.26-51-412(a) Property Acquired as a Result of an Involuntary Conversion

In the case of property acquired as a result of an involuntary conversion, the basis of the property shall be the same as that of the property so converted with the following adjustments:

- a) decreased in the amount of any money received by the taxpayer which was not expended;
- b) increased in the amount of the gain; and
- c) decreased in the amount of loss to the taxpayer recognized upon such conversion applicable to the year in which the conversion was made. See 1.26-51-404(b)(1).

In any case where the taxpayer elects to replace or restore the converted property but it is not feasible to do so immediately, the taxpayer may obtain permission to establish a replacement fund in which part or all of the compensation received shall be held, without any deduction for the payment of a mortgage. The taxpayer should apply to the Department for permission to establish a replacement fund. The application should recite all the facts relating to the transaction and declare that the taxpayer will proceed as quickly as possible to replace or restore such property. The taxpayer will be required to furnish a surety bond in an amount not to exceed double the estimated additional income taxes which would be payable if no replacement fund were established. The estimated additional taxes for the amount of which the taxpayer is required to furnish security should be computed at the rates at which the taxpayer would normally be required to pay. Only surety companies will be approved as sureties. The application should be executed in triplicate, so that the Department, the taxpayer and the surety or depository may each have a copy.

1.26-51-412(b) Basis of Stock Received for Property

During the initial start-up of a corporation, the stock or securities of the corporation exchanged for real or personal property transferred to the corporation shall be deemed to have the same value or cost as the property so transferred and no gain or loss shall arise from the transaction.

The cost or value of the property transferred (adjusted as to depreciation and depletion) shall be entered in the records of the taxpayer as the purchase price of its stock in the corporation and a record of such cost must be maintained. Gain or loss in future sales of such stock shall be measured by the difference between the individual cost per share determined as above to the selling price of such stock.

1.26-51-412(c) Reorganization, Merger, and Consolidation

A "merger" or "consolidation" includes:

(1) The acquisition by one corporation of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the property of another corporation;

(2) A transfer by one corporation of all or a part of its assets to another corporation if, immediately after the transfer, the transferor or its stockholders or both are in control of the corporation to which the assets are transferred;

(3) A recapitalization; or

(4) A mere change in identity, form, or place of organization,

however effected.

The term "a party to a reorganization" as used in ACA 26-51-412 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock of another corporation.

A person is, or two or more persons are, "in control" of a corporation within the meaning of ACA 26-51-412 when owning:

- (1) At least 80 percent (80%) of the voting stock; **and**
- (2) At least 80 percent (80%) of the total number of shares of all other classes of stock of the corporation.

2.26-51-412(c) Exchange of Property in a Reorganization

No gain or loss shall be recognized if:

- a) pursuant to a reorganization plan, stock or securities in a corporation are exchanged solely for stock or securities in the same corporation or in another party to the reorganization; or
- b) pursuant to a reorganization plan, a party to a reorganization exchanges property solely for stock or securities in another party to the reorganization.

3.26-51-412(c) Exchange of Property in a Reorganization

Pursuant to a reorganization plan, if stock or securities in a corporation are exchanged for stock or securities in the same corporation or in another party to the reorganization **including other property or money as well**, any gain to the recipient shall be recognized in an amount not to exceed the sum of the money and the fair market value of the other property. No loss from such an exchange will be recognized.

Pursuant to a reorganization plan, if property is exchanged by a party to the reorganization for stock or securities in another party to the reorganization **including other property or money as well**, if the other property or money received by the corporation is distributed by it pursuant to the reorganization plan, no gain to the corporation will be recognized. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, any gain to the corporation from the exchange will be recognized in an amount not to exceed the sum of the money and the fair market value of the other property so received. In either case, no loss from the exchange will be recognized.

4.26-51-412(c) Securities Received in a Reorganization

If, without any surrender of his stock or securities, a shareholder of a party to a reorganization receives stock or securities in such corporation or in another party to the reorganization pursuant to a reorganization plan, no gain to the shareholder will be recognized.

5.26-51-412(c) Securities Received in a Reorganization -- Basis

In the case of stock or securities acquired by a shareholder in connection with the transactions described in Regulation 3.26-51-412(c), the cost or assessed value of the stock upon which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis of each share will be the quotient (or result) of the cost or assessed value of the old shares of stock divided by the total number of the old and new shares.

When the stock distributed in a reorganization is materially different from the stock upon which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed. The basis of each share of stock will be the quotient (or result) of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class.

When the stock upon which a distribution in reorganization is made was purchased at different times and prices, and the identity of the lots cannot be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see Reg. 2.26-51-411), and any sale of the stock distributed in the reorganization will be presumed to have been made from the stock distributed upon the earliest purchased stock.

Where the stock upon which a distribution in reorganization is made was purchased at different times and prices, and the stock distributed in the reorganization cannot be identified as having been distributed upon any particular lot of such stock, then any sale of the stock distributed in the reorganization will be presumed to have been made from the stock distributed upon the earliest purchased stock.

26-51-413 CORPORATE LIQUIDATIONS

1.26-51-413 Treatment of Amounts Distributed in Liquidation

Amounts distributed in **complete** liquidation of a corporation are to be treated as full payment for all stock issued. Amounts distributed in **partial** liquidation are to be treated as full payment for the stock which was canceled or redeemed.

The gain or loss to a shareholder from a distribution in liquidation is to be determined by comparing the amount of the distribution with the cost or other basis of the stock. In the case of amounts distributed in partial liquidation (other than a distribution pursuant to a reorganization plan as described in ACA 26-51-412), the part of such distribution which is properly chargeable to the capital account shall not be considered a distribution of earnings or profits within the meaning of ACA 26-51-411 for the purpose of determining the taxability of a subsequent distribution by the corporation.

2.26-51-413 Election of Subchapter S Corporation Status

A taxpayer who has elected to be treated as an S corporation for federal income tax purposes but not for state income tax purposes (therefore retaining its C corporation status), must file a §338 election with the Department's Individual Income Tax Section stating that it desires to be taxed in accordance with IRC Section 338. This is so despite the fact that the taxpayer may already have a §338 election on file with the IRS.

If the taxpayer has elected to be treated as an S corporation for **both** federal and state income tax purposes, and the taxpayer has also filed a §338 election with the IRS, the taxpayer need not file a separate §338 election with the Department. The taxpayer will automatically receive §338 treatment by the Department for state income tax purposes as well.

If the taxpayer has elected to be treated as a C corporation for **both** federal and state income tax purposes, and the taxpayer has also filed a §338 election with the IRS, the taxpayer need not file a separate §338 election with the Department. The taxpayer will automatically receive §338 treatment by the Department for state income tax purposes as well.

26-51-414 DEFERRED COMPENSATION PLANS

1.26-51-414 Savings Incentive Match Plan for Employees (SIMPLE)

Beginning in tax years after 1996, eligible employers may maintain SIMPLE retirement plans to provide a tax-favored means of providing for employees' retirement. An eligible employer is

an employer that:

1. Employs no more than 100 employees who each received at least \$5,000 of compensation from the employer the preceding year; and
2. Does not maintain another employer-sponsored retirement plan to which contributions were made or benefits accrued.

An eligible employer who establishes and maintains a SIMPLE plan for at least one year, but thereafter fails to qualify, continues to be treated as an eligible employer for the two years following the last year in which it did qualify.

An employee is eligible to participate in any calendar year if he or she received at least \$5,000 of compensation from the employer during each of the two preceding calendar years and is reasonably expected to receive at least \$5,000 in compensation during the current calendar year. A self-employed individual is treated as an employee and may participate in a SIMPLE plan if the compensation threshold is met.

There are two types of SIMPLE plans:

1. Cash or deferred arrangement (CODA) incorporated in a qualified plan (IRC Sec. 401(k)(11)(c)); or
2. An IRA established for each participating employee.

A SIMPLE plan must permit each eligible employee to elect to have the employer make payments either (1) directly to the employee in cash or (2) as a contribution to the SIMPLE account. No contribution, other than elective contributions, employer matching contributions, and nonelective employer contributions may be made to a SIMPLE account. However, a rollover from another SIMPLE account may be received.

Elective contributions are limited to \$6,000 for any calendar year. The employer must match the elective contribution of an employee in an amount not exceeding three percent (3%) of the employee's compensation. However, the employer may elect to limit its match, for all eligible employees, to a smaller percentage of compensation not less than one percent (1%). The election may not be made in more than two out of every five years.

Nonelective contributions may be made as an alternative to matching contributions. The employer may elect to make nonelective contributions of two percent (2%) of compensation for each employee who is eligible to participate and who has at least \$5,000 of compensation from the employer for the calendar year.

The compensation that may be taken into account in determining

the two percent nonelective contribution may not exceed an indexed dollar amount. For 1996, this amount is \$150,000 for most plans.

Elective contributions of employees are not includable in gross income when made. They are taxed only under the distribution rules that govern distributions from conventional IRAs. IRC Sec. §408(p)(i)(A). Any elective contributions under this plan are included in the sum of elective deferrals, subject to an annual limit on the amount that can be excluded from income. IRC Sec. 402(g)(3)(D).

The employer is entitled to a deduction for its contributions to a SIMPLE account. For deduction purposes, the employer contributions to a SIMPLE account are treated as if they were made to a plan subject to the requirements of IRC Sec. 404(m).

For self employed persons, the contribution is not a business expense, therefore it is not deductible on the schedule C. In the case of a sole proprietorship the contribution may only be claimed as an adjustment to income.

Example: XYZ Company maintains a SIMPLE retirement plan for its eligible employees. Melinda Jones earns \$30,000 from XYZ Company. The company matches the elective contribution in the amount of 3% of the employee's compensation. Ms. Jones elects to contribute \$6,000.00 to her SIMPLE account. Ms. Jones has no other income deferrals. XYZ Company makes a matching contribution of \$720.00 to Ms. Jones' SIMPLE account. $[(\$30,000 - \$6,000) \times 3\%]$. Ms. Jones' wages reported on her W-2 are \$24,000.00 and XYZ Company may deduct the \$720.00 as an expense.

26-51-416 DEDUCTIONS - TAXES

1.26-51-416 State Income Taxes

No deduction will be allowed for Arkansas state income taxes in the computation of net income. All other states' income taxes are deductible.

26-51-419 DEDUCTIONS - CHARITABLE CONTRIBUTIONS

1.26-51-419 Charitable Contributions

Arkansas has adopted IRC Section 170 as referenced in ACA 26-51-419. Section 170(d)(2)(B) does not allow unused contributions to increase NOL carry forward. It merely decreases net taxable income by current year contributions first, then any accumulated contribution carryforwards up to a 10% limitation. This decreases the amount of NOL used and increases the NOL available

for future years.

EXAMPLE:	1989	1990	1991	1992	1993	1994	1995
Income	\$107,000	\$107,000	\$107,000	\$108,000	\$110,000	\$ 80,000	\$150,000
Deductions Excluding Amortization & Charitable Deductions	<u>105,000</u>	<u>105,000</u>	<u>105,000</u>	<u>105,000</u>	<u>105,000</u>	<u>105,000</u>	<u>105,000</u>
Taxable Income Before Amortization, Charitable Deductions and NOL	2,000	2,000	2,000	3,000	5,000	(25,000)	45,000
Amortization of Organizational Expenditures	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	φ	φ
Charitable Deductions Allowed	<u>φ</u>	<u>φ</u>	<u>φ</u>	<u>(100)</u>	<u>(300)</u>	<u>φ</u>	<u>(4,500)</u>
Taxable Income (Loss) before NOL	φ	φ	φ	900	2,700	(25,000)	40,500
Net Operating Loss	φ	φ	φ	φ	φ	φ	(25,000)
Taxable Income (Loss)	φ	φ	φ	900	2,700	(25,000)	15,500
Taxable Income Before Amortization, Contributions and NOL	2,000	2,000	2,000	3,000	5,000	(25,000)	45,000
Organizational Expenses	<u>(2,000)</u>	<u>(2,000)</u>	<u>(2,000)</u>	<u>(2,000)</u>	<u>φ</u>	<u>φ</u>	<u>φ</u>
Contribution Limitation Base	φ	φ	φ	1,000	3,000	N/A	45,000
Limitation	<u>X .10</u>	<u>X .10</u>	<u>X .10</u>	<u>X .10</u>	<u>X .10</u>	<u>N/A</u>	<u>X .10</u>
Contributions Allowed	φ	φ	φ	100	300	N/A	4,500

LIMITS ON CHARITABLE CONTRIBUTIONS

YEAR	CONTRIBUTIONS	UTILIZED CURRENT YEAR LIMIT	CURRENT YEAR BALANCE	PRIOR YEARS CONTRIBUTION UTILIZED	YEAR END CUMMULATIVE CARRYFORWARD	EXPIRED
1989	1,000	φ	1,000	φ	1,000	φ
1990	1,000	φ	1,000	φ	2,000	φ
1991	1,000	φ	1,000	φ	3,000	φ
1992	1,000	100	900	φ	3,900	φ
1993	1,000	300	700	φ	4,600	φ
1994	1,000	φ	1,000	φ	4,600	1,000*
1995	1,000	1,000	φ	3,500	1,100	φ

Southern Arkansas Timber, Inc. started business on 01/01/89.

Organization expenses amounted to \$10,000. Amortization of organization expenditures is deducted before the 10% limit is allowed. Any unused charitable contributions cannot be added to NOLs when they expire.

- * Contribution carryover from 1989 expired at the end of 1994 as shown in chart.

For charitable contributions for consolidated filers, refer to ACA 26-51-805(f).

26-51-423 DEDUCTIONS - EXPENSES

1.26-51-423(b) Travel and Entertainment

For tax years beginning before 01/01/95, IRC Section 274 as in effect 01/01/89 shall apply. For tax years beginning on or after 01/01/95, IRC Section 274 as in effect 01/01/95 shall apply. Eighty percent (80%) of qualified expenses will be allowed in tax years beginning before 01/01/95, and 50% of qualified expenses will be allowed in tax years beginning on or after 01/01/95. For

tax years beginning on or after 01/01/97, IRC Section 274 as in effect on 01/01/97 shall apply. The percentage will gradually rise beginning in 1998 as set forth below:

For taxable years beginning in calendar year -	The applicable percentage is -
1998 or 1999	55%
2000 or 2001	60%
2002 or 2003	65%
2004 or 2005	70%
2006 or 2007	75%
2008 or thereafter	80%

26-51-424 DEDUCTIONS - LOSSES

1.26-51-424(a)(1) Losses

Losses sustained during the tax year, not compensated for by insurance or otherwise, are fully deductible. Losses must usually be evidenced by closed and completed transactions. The basis for determining the amount of the deduction for loss is the same as is provided in ACA 26-51-411 for determining the gain or loss from the sale or other disposition of property. Proper adjustments must be made in each case for expenditures, receipts, losses or other items properly chargeable to the capital account and for depreciation, obsolescence, amortization or depletion. Moreover, the amount of the loss must be reduced by the amount of any insurance or other compensation received and by the salvage value, if any, of the property.

2.26-51-424(a)(1) Removal or Demolition of Buildings

Losses due to the voluntary removal or demolition of old buildings and the scrapping of old machinery or equipment incidental to renewal or replacement are deductible from gross income. When a taxpayer buys real estate upon which is located a building which he proceeds to raze with the intent of erecting thereon another building, the taxpayer has incurred no deductible loss or expense on account of the demolition of the old building. The basis in the real estate will be increased by the cost of the demolition.

3.26-51-424(a)(1) Obsolescence of Capital Assets

When the usefulness of some or all of a taxpayer's capital assets ends causing the taxpayer to discontinue use of, or permanently discard, such assets from use in the business, the taxpayer may claim as a loss for the year in which it takes such action the difference between the cost of the assets (less depreciation, etc.) and the salvage value thereof. This deduction does not extend to a case where the useful life of property ends solely as a result of those gradual processes for which depreciation allowances may be taken (wear and tear), nor does it apply to

inventories or to any assets other than capital assets. Moreover, this deduction applies to buildings only when they are permanently abandoned and to machinery only when its intended use has been permanently discontinued. Any loss to be deducted under this provision must be fully explained in the taxpayer's income tax return.

4.26-51-424(a)(1) Shrinkage in Value of Stock

Unless the lower of cost or market **or** mark to market methods are used for tax purposes, the owner of stock in a corporation cannot deduct from gross income a loss due to shrinkage in value of such stock through fluctuations in the market or otherwise until the stock is sold. The allowable loss is the amount realized when the stock is sold. If the stock of a corporation becomes worthless, the stock's tax basis may be deducted in the tax year in which the stock became worthless.

5.26-51-424(a)(1) Farm Losses

Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for a more favorable market, no deductions for shrinkage in weight or physical value by reason of deterioration in storage shall be allowed. Shrinkage may be allowed if an inventory is used to determine profits.

The total loss by frost, storm, flood or fire of a crop not yet harvested is not a deductible loss in computing net income.

A farmer engaged in raising and selling livestock, such as poultry, hogs, cattle, sheep, horses, etc., is not entitled to claim as a loss the value of such animals raised on the farm that perish, unless an inventory is used. The cost of any feed, pasture, or care which has been deducted as an expense of operation shall not be included as part of the cost of the livestock for the purpose of ascertaining the amount of deductible loss.

If a taxpayer owns and operates a farm in addition to being engaged in another trade, business, or calling and sustains a farm related loss, the amount of the farming loss sustained may be deducted from gross income received from all sources, provided the farm is operated for profit and not for recreation or pleasure.

26-51-425 DEDUCTIONS - WORTHLESS DEBTS

1.26-51-425 Worthless Debts

Where a debt is worthless, either wholly or in part, the amount which is worthless and charged off or written down to a nominal amount on the books of the taxpayer shall be allowed as a

deduction in computing net income. **There shall accompany the return a statement showing the propriety of any deduction claimed for bad debts.** Before a taxpayer may charge off and deduct a debt in part, he must ascertain and be able to demonstrate with a reasonable degree of certainty the amount which is uncollectible. An amount subsequently received on account of a bad debt previously charged off and allowed as a deduction for income tax purposes, must be included in gross income in the tax year in which received.

Bankruptcy of the debtor is generally an indication of the worthlessness of at least part of an unsecured and unpreferred debt. Actual determination of worthlessness in bankruptcy cases is sometimes possible before and, at other times, only when settlement in bankruptcy has been made. Where a taxpayer ascertained a debt to be worthless and charged it off in one tax year, the fact that the debtor's bankruptcy proceedings are terminated in a later tax year (confirming that the debt is worthless) will not authorize shifting the deduction to such later tax year. If a taxpayer computes its income upon the basis of valuing its notes or accounts receivable at their fair market value when received (which may be less than their face value), the amount deductible as a bad debt is limited to such original valuation.

Worthless debts arising from unpaid wages, salaries, rents and similar items of taxable income will not be allowed as a deduction unless such items have been entered as income in the books of the taxpayer in a prior tax year or in the tax year in which the deduction was made. Only the difference between the amount received in distribution of the assets of a bankruptcy and the amount of the claim may be deducted as a bad debt. The difference between the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate and the amount of the creditor's claim may be considered a worthless debt. A purchaser of uncollectible accounts receivable which are subsequently charged-off the purchaser's books as bad debts is entitled to deduct them, the amount of the deduction to be based upon the price actually paid for the accounts receivable and not upon their face value.

2.26-51-425 Sale of Mortgaged or Pledged Property

Where mortgaged or pledged property is sold for less than the amount of the debt and the mortgagee or pledgee determines that the portion of the debt remaining unsatisfied after such sale is uncollectible and charges it off, such amount may be deducted as a bad debt for the tax year in which it is determined to be worthless and charged-off.

Accrued interest may be included as part of the deduction only when it has previously been reported as income.

3.26-51-425 - Bonds and Other Similar Obligations

Bonds, when determined to be worthless, may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which, on foreclosure, nothing is realized for the bondholders, are regarded as worthless no later than the tax year of the foreclosure sale. No deduction for a bad debt is allowable in computing a bondholder's income for any subsequent tax years.

A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations, cannot deduct from gross income any losses on account of market fluctuations that occur prior to maturity of the debt instruments. However, when a taxpayer determines **upon maturity** that it will recover none or only a part of the debt evidenced by the bonds or other similar obligations, the taxpayer may deduct the uncollectible part of such debt. In order for this deduction to be properly taken, the taxpayer must include with its return an explanation or other proof which substantiates the deduction.

26-51-426 DEDUCTIONS - RESERVE FOR BAD DEBTS OR LIABILITIES

1.26-51-426 Bad Debt Expense

A business is generally allowed to take a bad debt expense. Any bank, savings and loan or any other institution chartered and supervised under federal or state laws shall be allowed a bad debt expense deduction computed in accordance with Internal Revenue Code Sections 582, 585, and 593, as in effect on January 1, 1997. Banks with assets over \$500,000,000 must use the specific charge-off method for bad debts.

26-51-427 DEDUCTIONS - NET OPERATING LOSS (NOL)

1.26-51-427 NOL Adjustments Beyond Statutory Limits

The fact that the statutory period for assessment or refund of income taxes for the year in which the loss was sustained has expired does not prevent the making of adjustments necessary to correct the NOL deduction. The NOL may be increased or decreased by any such adjustment.

Example:

Corporation took a nondeductible expense in 1993. This was not detected until a return claiming a NOL was filed in 1997.

Tax Year 1993	<u>As Filed</u>	<u>As Corrected</u>
NTI as reported by taxpayer	\$(15,000)	\$(15,000)

Addback: Nondeductible Expense	- -	20,000
Corrected Net Taxable Income	- -	\$ 5,000

Tax Year 1997

NTI as reported by taxpayer	\$25,000	\$25,000
NOL claimed by taxpayer	(15,000)	- -
NOL available from 1993	- -	-0-
Net Taxable Income as filed	\$10,000	- -
Corrected Net Taxable Income	- -	\$25,000

The 1993 tax year is outside the statute of limitations and cannot be assessed. However, the NOL for 1993 can be adjusted to the allowed or disallowed amount.

1.26-51-427(3)(C) NOL Carryover Due to Merger

In the case of a merger between two corporations that are owned by the same entity and that same entity owns at least 80% of the voting stock of each corporation, the formula for establishing that the assets of the merged corporation (that is, the corporation going out of existence) are still producing income is as follows:

$$\frac{\text{Original Cost of Merged Assets}}{\text{Original Cost of All Assets}} \times \text{Total Income}$$

The carryover losses will be allowed only in those cases where the assets of the corporation going out of existence earn sufficient profits apportionable to Arkansas under § 26-51-701 et seq. in the post-merger period to absorb the carryover losses claimed by the surviving corporation.

26-51-428 DEDUCTIONS - DEPRECIATION AND EXPENSING OF PROPERTY

1.26-51-428(a) Depreciation

For property placed in service during tax years beginning before 01/01/95, Sections 167, 168 and 179 of the Internal Revenue Code as in effect on 01/01/91 shall apply. The Section 179 deduction is limited to \$10,000.

For tax years beginning on or after 01/01/95 and beginning on or before 12/31/96, the deduction is limited to \$17,500.

The schedule below shows the phase-in adopted under Section 179 as in effect on 01/01/97.

Tax Period Beginning in:	Applicable Amount:
1997	\$18,000
1998	\$18,500
1999	\$19,000
2000	\$20,000
2001	\$24,000
2002	\$24,000
2003 & thereafter	\$25,000

Any Section 179 expense disallowed because of the limitation may be depreciated by regular depreciation methods appropriate for that property or it may be carried forward.

Property placed in service during tax years beginning before 01/01/95 will have a useful life as determined by Section 168 as in effect on 01/01/91. Property placed in service during tax years 1995 and 1996 will have a useful life as determined by Section 168 as in effect on 01/01/95. Property placed in service beginning on or after 01/01/97 will have a useful life as determined by Section 168 as in effect on 01/01/97.

Any differences in basis because of depreciation differences must be included in the calculation of gain or loss upon disposition of the property.

1.26-51-428(c) Amortization of Intangibles

For tax years beginning before 01/01/95, Section 167 regarding amortization of intangibles shall apply. For tax years beginning on or after 01/01/95, Section 197 shall apply.

Any differences in Arkansas and federal law concerning the computation of basis must be considered in calculating gain or loss upon disposition of the intangibles.

26-51-440 FEDERAL SUBCHAPTER M

1.26-51-440 Federal Subchapter M Adopted

Subchapter M of the Internal Revenue Code as in effect on 01/01/97 has been adopted with the exception of its tax rates.

Arkansas tax rates remain in effect as set forth in ACA 26-51-205. If a federal election is made relating to a RIC, REIT, FASIT or any other corporation registered as an investment company, the same election is automatically deemed to have been made for Arkansas income tax purposes.

If a corporation no longer qualifies as initially elected, then it must file an Arkansas corporation income tax return and be taxed as a "C" corporation.

26-51-440 FASITs

2.26-51-440 Definition

A new type of statutory entity called a financial asset securitization investment trust (FASIT) has been created to facilitate the securitization of debt obligations such as credit card receivables, home equity loans, and auto loans. An entity that qualifies as a FASIT can issue instruments that are treated as debt for federal income tax purposes whether or not they would be so treated under normal tax principles. In addition, a FASIT itself generally is not taxable, and any taxable income or net loss which it has flows through to the equity owner of the FASIT. The interest on debt instruments issued by FASITs is deductible.

3.26-51-440 Qualification Requirements

To qualify for status as a FASIT, an entity must meet several requirements, which are specifically set forth at IRC Sec. 860L(a)(1). Any entity, including a corporation, partnership or trust may be treated as a FASIT.

The ownership of a FASIT (that is, the "ownership interest"), must be held directly by an "eligible corporation." IRC Sec. 860L(a)(1)(C). An eligible corporation is a nonexempt domestic C corporation which does not qualify as a RIC, REIT, REMIC or cooperative. Moreover, the ownership interest of a FASIT must generally be entirely held by a single domestic C corporation. IRC Sec. 860L(a)(2).

The FASIT issues debt instruments, called "regular interests," which are in the nature of bonds. These regular interests would normally be purchased by investors and feature the following characteristics:

- a. The investor is unconditionally entitled to receive a specified amount of principal;
- b. Interest is paid on the principal;
- c. A stated term to maturity of usually no more than 30 years; and
- d. In some cases, a FASIT may issue a high-yield interest rather than a regular interest. The tax treatment to investors of a high-yield interest is different from a regular interest. IRC Sec. 860L(b)(1)(B).

For an entity to qualify as a FASIT, substantially all of its assets must consist of "permitted assets" as defined at IRC Sec. 860L(c)(1). The assets of a FASIT are considered to be owned directly by the holder of the ownership interest.

4.26-51-440 Taxation of FASITs

A FASIT is not subject to income tax, and is not treated as a trust, partnership or corporation. Instead, all of the FASIT's assets and liabilities are treated as the assets and liabilities of the FASIT's owner. Any income, gain, deduction, credit or loss of the FASIT is allocable directly to its owner.

Any FASIT income subject to Arkansas income tax shall be taxed at the corporate rates set forth in ACA 26-51-205. No special Arkansas income tax return has been created specifically for FASITs. As noted above, FASIT income passes through to the FASIT's owner. The FASIT's owner is responsible for reporting any such income on the owner's return and paying any Arkansas individual income tax due. Once an election to be a FASIT is made, the election applies for that tax year and all subsequent years until such time that the election is revoked with the consent of the IRS.

All members of an affiliated group filing a consolidated return are to be treated as one taxpayer. IRC Sec. 860J(d). Specifically, the provision that the taxable income of a holder of a FASIT ownership interest cannot be less than the taxable income with respect to the FASIT interest applies to any consolidated group of corporations of which the holder is a member as if the group were a single taxpayer.

The holder of a FASIT ownership interest cannot offset income or gain from the FASIT ownership interest with nonFASIT losses. IRC Sec. 860J.

The taxable income of a FASIT (in determining the taxable income of the holder of an ownership interest) should be calculated using an accrual method of accounting. IRC Sec. 860H(b)(2).

5.26-51-440 Taxation of Regular Interests.

The holder of a regular or high-yield interest in a FASIT (normally an investor), is generally taxed in the same manner as a holder of any other debt instrument. IRC Sec. 860H(c)(1).

6.26-51-440 Prohibited Transactions

In order to ensure that FASITs are not used for purposes other than securitization, a 100% federal excise tax is imposed on any income not related to securitization (that is, income derived from prohibited transactions). Prohibited transactions are specifically set forth at IRC Sec. 860L(e)(1)&(2).

7.26-51-440 Transfers of Assets to FASITs

Where the holder of the ownership interest in a financial asset securitization investment trust (FASIT) or a related person sells

or contributes property to the FASIT, gain is recognized immediately in an amount equal to the excess (if any) of the property's value on the date of the contribution over its adjusted basis on that date. This gain is recognized notwithstanding any other income tax code provision, and the basis of any property is increased by the amount of gain recognized. IRC Sec. 860I.

Losses on assets contributed to the FASIT are not allowed upon their contribution, but may be allowed to the FASIT owner upon their disposition by the FASIT.

26-51-509 YOUTH APPRENTICESHIP PROGRAM

1.26-51-509 Youth Apprenticeship Credits

Youth apprenticeship programs under ACA 26-51-1601 et seq. are certified by the Arkansas Department of Education, Votech Division. Program related income tax credits are then verified and issued by the Department's Tax Credits/Special Refunds Section. The original certificate issued by the Tax Credits Section must be attached to the taxpayer's first year income tax return upon which the credit is being claimed. The credit cannot exceed the amount of income tax due and can be carried forward for up to two (2) consecutive tax years immediately following the tax year in which the credit originated.

ACA 26-51-1601 et seq., enacted in 1997, extends the availability of the credit to youth who do not qualify under ACA 26-51-509.

ACA 26-51-1601 et seq. applies to tax years beginning on and after 01/01/98. ACA 26-51-509 applies to tax years beginning on and after 01/01/96. Any registered apprenticeship program under Section 509 must conform to federal regulations in effect on 01/01/95. Allowable credits and carryforward time are the same between ACA 26-51-509 and 26-51-1601.

26-51-701 MULTISTATE BUSINESS INCOME

1.26-51-701 Source of Law

Arkansas has adopted the Uniform Division of Income for Tax Purposes Act ("UDITPA") at ACA 26-51-701 et seq. and the Multistate Tax Compact at ACA 26-5-101 et seq.

2.26-51-701 Business versus Nonbusiness Income

"Business income" means income arising from transactions and activities in the regular course of a taxpayer's trade or business. Business income also includes income from tangible and intangible property if the acquisition, management and disposition (sale, exchange, etc.) of such property is an integral part of the taxpayer's regular trade or business

operations.

"Nonbusiness income" means all income other than business income.

The classification of income by labels, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, nonoperating income, etc., should not be the sole factor used in determining whether income is business or nonbusiness income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity which are the elements of a particular trade or business. In general, all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, a trade or business.

Rental income from real and tangible property is business income if the property generating the rental income is used in the taxpayer's trade or business and is includable in the property factor.

Gain or loss from the sale, exchange or other disposition of real property or of tangible or intangible personal property constitutes business income if the property, while owned by the taxpayer, was used in the taxpayer's trade or business. However, if the property was utilized for the production of nonbusiness income before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income.

Interest income is business income where the intangible receiving the interest arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible is related to or incidental to such trade or business operations.

Dividends are business income where the stock earning such dividends arises out of or was acquired in the regular course of the taxpayer's trade or business operations or where the purpose of acquiring and holding the stock is related to or incidental to such trade or business operations.

Patent and copyright royalties are business income where the patent or copyright receiving the royalties arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the patent or copyright is related to or incidental to such trade or business operations. For intangible income from related parties, see Income Tax Regulation 1996-3.

3.26-51-701 Unitary Business Principle

The determination of whether income constitutes business income depends upon whether a unitary relationship exists between the income in question and a taxpayer's business activities in Arkansas. A unitary relationship exists when an activity conducted in one state benefits or is benefited by an activity in another state. Certain factors of profitability such as functional integration, centralization of management and economies of scale may be used to indicate the contribution made to the overall business enterprise. These factors help determine the existence of a unitary relationship for classifying income as business income. However, Arkansas will not accept returns filed on a unitary combined basis.

The determination of whether the activities of the taxpayer constitute a single trade or business or more than one trade or business will turn on the facts in each case. In general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole. The following factors are considered to be reliable indicators of a single trade or business, and the presence of any of these factors creates a strong presumption that the activities of the taxpayer constitute a single trade or business:

(1) Same type of business. A taxpayer is generally engaged in a single trade or business when all of its activities are in the same general line. For example, a taxpayer which operates a chain of retail grocery stores will almost always be engaged in a single trade or business.

(2) Steps in a vertical process. A taxpayer is almost always engaged in a single trade or business when its various divisions or segments are engaged in different steps in a large, vertically structured enterprise. For example, a taxpayer which explores for and mines copper ores; concentrates, smelts and refines the copper ores; and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the taxpayer's executive offices.

(3) Strong centralized management. A taxpayer which might otherwise be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is a strong central management, coupled with the existence of centralized

departments for such functions as financing, advertising, research, or purchasing. Thus, some conglomerates may properly be considered as engaged in only one trade or business when the central executive officers are normally involved in the operations of the various divisions and there are centralized offices which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing.

26-51-702 APPORTIONMENT - DETERMINATION OF NEXUS

1.26-51-702 Apportionment of Net Income Authorized

If a taxpayer's business activities occur both within and outside of Arkansas, the taxpayer shall apportion its business income and allocate any nonbusiness income to Arkansas as provided by Arkansas law. "Taxpayer" means any corporation, partnership, firm, association or person acting as a business entity in more than one state. See ACA 26-5-101, Art. II(3).

2.26-51-702 Nexus Generally

Generally, a taxpayer has nexus with Arkansas if its business activity in Arkansas goes beyond the mere solicitation of orders for the sale of tangible personal property as set forth in Public Law 86-272, which is codified at 15 U.S.C. §381.

3.26-51-702 Nature of Property Being Sold

Only the solicitation to sell tangible personal property is afforded protection under 15 U.S.C. §381. Therefore, the leasing, renting, licensing or other disposition of tangible personal property, or transactions involving intangibles, such as franchises, patents, copyrights, trade marks, service marks and the like, or any other type of property, are not protected activities under 15 U.S.C. §381.

4.26-51-702 Solicitation of Orders

For in-state activity to be protected under 15 U.S.C. §381, it must be limited solely to the solicitation of orders that if approved, will be filled by shipment or delivery from a point outside of Arkansas. "Ancillary" activities described in 5.26-51-702, "de minimis" activities described in 6.26-51-702 and those activities conducted by independent contractors described in 7.26-51-702 are protected activities which, by themselves, will not establish nexus. "Solicitation" means (1) speech or conduct that explicitly or implicitly invites an order and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary (that is, related) to requests for an order.

5.26-51-702 Ancillary Activities

Ancillary activities are those activities that serve no independent business function for the seller apart from their connection to the solicitation of orders. "Ancillary" activities are related solely to the solicitation of orders. Activities that a seller engages in apart from soliciting orders shall not be considered as ancillary to the solicitation of orders. The mere assignment of certain activities to sales personnel does not, merely by such assignment, make such activities ancillary to the solicitation of orders. Activities that seek to "promote" sales, such as some marketing activities, are not ancillary, as 15 U.S.C. §381 does not protect activity that facilitates sales; 15 U.S.C. §381 only protects ancillary activities that facilitate the request for an order. Engaging in activities which do not fall within the foregoing definition of "solicitation" will cause the taxpayer to lose the protection afforded by 15 U.S.C. §381 unless the disqualifying activities, taken together, are "de minimis" as described in 6.26-51-702.

6.26-51-702 De Minimis Activities

De minimis activities are those activities that, when taken together, establish only a trivial or minor connection with Arkansas. An activity conducted within Arkansas on a regular or systematic basis or pursuant to a company policy, whether such policy is in writing or not, will not be considered trivial. Whether or not an activity establishes a trivial or nontrivial connection with Arkansas is to be measured on both a qualitative and quantitative basis. If such activity either qualitatively or quantitatively creates a nontrivial connection with Arkansas, then such activity exceeds the protection of 15 U.S.C. §381. Establishing that the disqualifying activities account for only a relatively small part of the business conducted within Arkansas or that the economic importance of such activities is minimal will not be determinative of whether a "de minimis" level of activity exists.

7.26-51-702 Independent Contractors

15 U.S.C. §381 provides protection to certain in-state activities if conducted by an independent contractor that would not be afforded if performed by the taxpayer or its employees or other representatives. Independent contractors may engage in the following limited activities in Arkansas without the taxpayer's loss of protection:

1. Soliciting sales;
2. Making sales; or
3. Maintaining an office.

Sales representatives who represent a single principal are not considered to be independent contractors and are subject to the same limitations as those provided under 15 U.S.C. §381 and these regulations.

Maintenance of a stock of goods in Arkansas by an independent contractor under consignment or any other type of holding arrangement with the taxpayer will remove the protection unless such stock is used only for purposes of display and solicitation.

8.26-51-702 Unprotected and Protected Activities

Examples of activities presently considered by the Department to be either protected or unprotected are as follows:

A. UNPROTECTED ACTIVITIES:

The following in-state activities, assuming they are not of a "de minimis" level, are not considered to be solicitation of orders or ancillary thereto or otherwise protected under 15 U.S.C. §381 and will cause otherwise protected sales to establish nexus:

1. Making repairs or providing maintenance or service to the property sold or to be sold;
2. Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise;
3. Investigating credit worthiness;
4. Installation or supervision of installation after shipment and delivery;
5. Conducting training courses, seminars or lectures for people other than those involved only in solicitation;
6. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders;
7. Investigating, handling, or otherwise assisting in resolving customer complaints;
8. Approving or accepting orders;
9. Repossessing property;
10. Securing deposits on sales;
11. Picking up or replacing damaged or returned property;

12. Hiring, training, or supervising personnel, other than personnel involved only in solicitation;
13. Using agency stock checks or any other similar instruments or processes by which sales are made within Arkansas by sales personnel;
14. Maintaining a sample or display room in excess of two weeks (14 days) at any one location within Arkansas during the tax year;
15. Carrying samples for sale or for distribution in any manner in exchange for valuable consideration;
16. Owning, leasing, using or maintaining any of the following facilities or property within Arkansas:
 - a. Repair shop;
 - b. Parts department;
 - c. Any kind of office (other than an in-home office as described and permitted under 8.26-51-702(A)(18) and 8.26-51-702(B)(2));
 - d. Warehouse;
 - e. Meeting place for the taxpayer's directors, officers, or employees;
 - f. Stock of goods (other than samples for sales personnel or that are used entirely ancillary to solicitation);
 - g. Telephone answering service that is publicly attributed to the taxpayer or to employees or agent(s) of the taxpayer in their representative capacity. For example, a listing in a telephone directory would constitute a "public" attribution;
 - h. Mobile stores, such as vehicles with drivers who are sales personnel making sales from the vehicles;
 - i. Real property or fixtures to real property of any kind;
17. Consigning a stock or inventory of goods or other tangible personal property to any person, including an independent contractor, for sale to customers;
18. Maintaining, by any employee or other representative,

an office or place of business of any kind. However, an "in-home" office will not cause a loss of protection if such an office is located within the residence of the employee or representative and:

- (a) is not publicly attributed to the taxpayer or to the employee or representative of the taxpayer in an employee or representative capacity; and
- (b) the use of such office is limited to soliciting and receiving orders from customers, for transmitting such orders outside of Arkansas for acceptance or rejection by the taxpayer, and for such other activities that are protected under 15 U.S.C. §381 or under 8.26-51-702(B) of this regulation.

A telephone listing or other public listing within the state for the taxpayer or for an employee or representative of the taxpayer in such capacity or other indications through advertising or business literature that the taxpayer or its employees or representative can be contacted at a specific address within Arkansas shall normally be determined as the taxpayer maintaining within Arkansas an office or place of business attributable to the taxpayer or to its employee or representative in a representative capacity. However, the normal distribution and use of business cards and stationery identifying the employee's or representative's name, address, telephone and fax numbers and affiliation with the taxpayer shall not, by themselves, be considered as advertising or otherwise publicly attributing an office to the taxpayer or its employee or representative.

The maintenance of any office or other place of business in Arkansas that does not strictly qualify as an "in-home" office as described above shall, by itself, cause the loss of protection under this regulation.

For the purpose of this regulation, it is not relevant whether the taxpayer pays directly, indirectly, or not at all for the cost of maintaining such in-home office;

- 19. Entering into franchising or licensing agreements, selling or otherwise disposing of franchises and licenses, or selling or otherwise transferring tangible personal property pursuant to such franchise

or license by the franchisor or licensor to its franchisee or licensee within Arkansas;

20. Shipping or delivering goods into Arkansas by means of **private** vehicle, rail, water, air or other carrier, regardless of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser; or
21. Conducting any activity in Arkansas not listed in paragraph "B" below which is not entirely ancillary to requests for orders, even if such activity helps to increase purchases (such as some marketing and promotional activities).

B. PROTECTED ACTIVITIES:

The following in-state activities will not cause the loss of protection for otherwise protected sales:

1. Soliciting orders for sales by any type of advertising. However, other marketing and promotional activities conducted within Arkansas can cause a loss of protection;
2. Soliciting of orders by an Arkansas resident employee or representative of the taxpayer, so long as such person does not maintain or use any office or other place of business in Arkansas other than an "in-home" office as described in 8.26-51-702(A)(18) above;
3. Carrying samples and promotional material only for display or for distribution without charge or other valuable consideration;
4. Furnishing and setting up display racks and advising customers on the display of the taxpayer's products without charge or other valuable consideration;
5. Providing automobiles to sales personnel for their use in conducting protected activities;
6. Passing orders, inquiries and complaints on to the home office;
7. Missionary sales activities, which is the solicitation of indirect customers for the taxpayer's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers would be protected if such solicitation activities are otherwise protected;
8. Coordinating shipment or delivery without payment or

other valuable consideration and providing information relating thereto either prior or subsequent to the placement of an order;

9. Checking of customers' inventories without a charge therefor (for reorder, but not for other purposes such as quality control);
10. Maintaining a sample or display room for two weeks (14 days) or less at any one location within Arkansas during the tax year;
11. Recruiting, training or evaluating sales personnel, including **occasionally** using homes, hotels or similar places for meetings with sales personnel; or
12. Owning, leasing, using or maintaining personal property for use in the employee or representative's "in-home" office or automobile, where the use of such personal property is solely limited to the conducting of protected activities. As such, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer and computer software in an "in-home" office or automobile that is strictly limited to the conducting of protected solicitation or activities entirely ancillary to such solicitation would be protected.

9.26-51-702 Application to Corporation Incorporated in Arkansas

The protection afforded by 15 U.S.C. §381 does not apply to any corporation incorporated by the Arkansas Secretary of State. See Arkansas Business Corporation Act of 1987, ACA 4-27-101 et seq.

10.26-51-702 Registration or Qualification to do Business

A taxpayer that registers or otherwise formally qualifies to do business within Arkansas does not, by that fact alone, lose its protection under 15 U.S.C. §381. However, if the taxpayer engages in activities within Arkansas that are not protected under 15 U.S.C. §381, such protection will be lost. See Arkansas Business Corporation Act of 1987, ACA 4-27-1501 et seq.

11.26-51-702 Loss of Protection for Conducting Unprotected Activity During Part of Tax Year

The protection afforded under 15 U.S.C. §381 will be determined on a tax year by tax year basis. Therefore, if at any time during a tax year the taxpayer conducts activities within Arkansas that are not protected under 15 U.S.C. §381, all income earned by the taxpayer attributable to Arkansas during such tax year will be subject to Arkansas income tax.

26-51-704 NONBUSINESS INCOME

1.26-51-704 Allocation of Nonbusiness Income

Generally, a taxpayer's nonbusiness income will be allocated to the state in which the taxpayer has its commercial domicile (that is, home office or corporate headquarters). However, under certain circumstances, a taxpayer's income from rents, royalties and capital gains may be allocable to Arkansas even though the taxpayer's commercial domicile is not located in Arkansas. See ACA 26-51-705 through 26-51-708.

26-51-709 APPORTIONMENT - BUSINESS INCOME

1.26-51-709 Determining Apportionment Factor

All business income of the taxpayer shall be apportioned to Arkansas by use of an apportionment formula. The apportionment formula consists of a fraction of which the numerator is the property factor plus the payroll factor plus double the sales factor and the denominator of which is four (4). A change in the law requires a double weighted sales factor for years beginning on or after 01/01/95. If the denominator is missing in one or more of the three factors, then the denominator of four must be reduced by the number of missing factors. For example, the denominator shall be the same as the number of entries, other than zero, that apply to the total (everywhere) amounts of the property, payroll and sales factors.

Examples 1 & 2 apply to tax years beginning before 01/01/95.
Examples 3 & 4 apply to tax years beginning after 01/01/95.

Example 1:

	(A) Amounts in <u>Arkansas</u>	(B) Total <u>Amounts</u>	(C) Percentage <u>(A) ÷ (B)</u>
Total Tangible Property	200,000	1,000,000	20.000000%
Payrolls	-0-	1,000,000	-0-
Sales	400,000	1,000,000	40.000000%
Sum of the Percentages			60.000000%
Percentage Attributable to Arkansas: $\frac{60.000000\%}{3} = 20.000000\%$			

Example 2:

	(A) Amounts in <u>Arkansas</u>	(B) Total <u>Amounts</u>	(C) Percentage <u>(A) ÷ (B)</u>
Total Tangible Property	100,000	1,000,000	10.000000%
Payrolls	-0-	-0-	-0-
Sales	400,000	1,000,000	40.000000%
Sum of the Percentages			<u>50.000000%</u>
Percentage Attributable to Arkansas: $\frac{50.000000\%}{2}$			
Sum of the Percentages divided by 2 = $\frac{50.000000\%}{2}$ = 25.000000%			

Example 3:

	(A) Amounts in <u>Arkansas</u>	(B) Total <u>Amounts</u>	(C) Percentage <u>(A) ÷ (B)</u>
Total Tangible Property	200,000	1,000,000	20.000000%
Payrolls	-0-	1,000,000	-0-
Sales	400,000	1,000,000	40.000000%
Double Weighted Sales Factor			<u>80.000000%</u>
Sum of the Percentages			100.000000%
Percentage Attributable to Arkansas: $\frac{100.000000\%}{4}$			
Sum of the Percentages divided by 4 = $\frac{100.000000\%}{4}$ = 25.000000%			

Example 4:

	(A) Amounts in <u>Arkansas</u>	(B) Total <u>Amounts</u>	(C) Percentage <u>(A) ÷ (B)</u>
Total Tangible Property	100,000	1,000,000	10.000000%
Payrolls	-0-	-0-	-0-
Sales	400,000	1,000,000	40.000000%
Double Weighted Sales Factor			<u>80.000000%</u>
Sum of the Percentages			90.000000%
Percentage Attributable to Arkansas: $\frac{90.000000\%}{3}$			
Sum of the Percentages divided by 3 = $\frac{90.000000\%}{3}$ = 30.000000%			

26-51-710 PROPERTY FACTOR**1.26-51-710 Includable Property**

Property shall be included in the property factor if it is actually used or is available for use or capable of being used

during the tax year in the regular course of the taxpayer's trade or business. Property held as reserves (including reserves of materials) and standby facilities shall be included in the factor. Property or equipment under construction during the tax year shall be excluded from the factor until such property is actually used in the regular course of the taxpayer's trade or business. "Goods in process" which can be or are included in the taxpayer's inventory shall be included in the property factor.

If the property is partially used in the regular course of the taxpayer's trade or business while under construction, the value of the property to the extent used shall be included in the property factor. Property used in the regular course of the taxpayer's trade or business shall remain in the property factor until its **permanent** withdrawal is established by an identifiable event, such as its conversion to the production of nonbusiness income, its sale, or the lapse of an extended period of time, normally five (5) years, during which time the property sits idle and is held for sale.

2.26-51-710 Consistency

If the taxpayer departs from or modifies the method of valuing property or of excluding property from or including property in the property factor used in returns for prior years, the taxpayer shall disclose in its Arkansas return for the current year the nature and extent of the modification.

If the returns filed by the taxpayer with all states to which the taxpayer reports are not uniform in the valuation of property or in the exclusion or inclusion of property in the property factor, the taxpayer shall disclose in its Arkansas return the nature and extent of the variance.

3.26-51-710 Numerator

The numerator of the property factor shall include the average value of the real and tangible personal property owned or rented by the taxpayer and used in Arkansas during the tax year in the regular course of the taxpayer's trade or business. Property in transit between locations of the taxpayer shall be considered to be at the destination for purposes of the property factor. Property in transit between a buyer and seller which is included by the taxpayer in the denominator of its property factor shall be included in the numerator according to the state of destination. The value of mobile or movable property such as construction equipment, trucks or leased electronic equipment which are located both inside and outside of Arkansas during the tax year shall be determined for purposes of the numerator of the factor on the basis of total time within Arkansas during the tax year. An automobile assigned to a traveling employee shall be included in the numerator of the factor on the basis of total miles driven within Arkansas compared to total miles driven everywhere during the tax year.

26-51-711 PROPERTY FACTOR - VALUATION OF PROPERTY

1.26-51-711 Owned Property

Property owned by the taxpayer shall be valued at its original cost. As a general rule, original cost is deemed to be the basis of the property for federal income tax purposes, prior to any federal adjustments, at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange, abandonment, etc. However, capitalized intangible drilling and development costs shall be included in the property factor whether or not they have been expensed for either federal or state tax purposes.

If the original cost of property is unascertainable, the property is included in the factor at its fair market value as of the date of acquisition by the taxpayer.

Inventory of stock of goods shall be included in the factor in accordance with the valuation method used for federal income tax purposes.

Property acquired by gift or inheritance shall be included in the factor at its basis for determining depreciation for federal income tax purposes.

2.26-51-711 Rented Property

Property rented by the taxpayer is valued at eight (8) times its net annual rental rate. The net annual rental rate for any item of rented property is the annual rental rate paid by the taxpayer for the property less the aggregate annual subrental rates paid by subtenants of the taxpayer.

If the subrents taken into account in determining the net annual rental rate produce a negative or clearly inaccurate value for any item of property, another method which will properly reflect the value of rented property may be required by the Director or requested by the taxpayer. In no case, however, shall the value be less than an amount which bears the same ratio to the annual rental rate paid by the taxpayer for the property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property.

If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal rate, the net annual rental rate for the property shall be determined on the basis of a reasonable market rental rate for the property.

Subrents are not deducted when they constitute business income

because the property which produces the subrents is used in the regular course of the taxpayer's trade or business when it is producing such income. Accordingly, there is no reduction in its value.

The term "annual rental rate" means the amount paid as rental for property for a 12 month period. Where property is rented for less than a 12 month period, the rent paid for the actual period of rental shall constitute the "annual rental rate" for the tax year. However, where a taxpayer has rented property for a term of 12 or more months and the current tax year covers a period of less than 12 months, the rent paid for the short tax year shall be annualized. If the rental term is for less than 12 months, the rent shall not be annualized beyond its term. Rent shall not be annualized because of the uncertain duration when the rental term is on a month-to-month basis.

The term "annual rent" means the actual sum of money or other consideration payable, directly or indirectly, by the taxpayer or for its benefit for the use of the property and includes:

1. Any amount payable for the use of real or tangible personal property, or any part thereof, whether designated as a fixed sum of money or as a percentage of sales, profits or otherwise; or
2. Any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs or any other items which are required to be paid by the terms of the lease or other arrangement, not including amounts paid as service charges, such as utilities, janitor services, etc. If a payment includes rent and other charges unsegregated, the amount of rent shall be determined by consideration of the relative values of the rent and other items.

Annual rent does not include the following:

1. Incidental day-to-day expenses such as hotel or motel accommodations, daily rental of automobiles, etc.; or
2. Royalties based on extraction of natural resources, whether represented by delivery or purchase. For this purpose, a royalty includes any consideration conveyed or credited to a holder of an interest in property which constitutes a sharing of current or future production of natural resources from such property, irrespective of the method of payment or how such consideration may be characterized, whether as a royalty, advance royalty, rental or otherwise.

Leasehold improvements shall, for the purposes of the property factor, be treated as property owned by the taxpayer regardless

of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. Hence, the original cost of leasehold improvements shall be included in the property factor.

26-51-713 PAYROLL FACTOR

1.26-51-713 Payroll Factor Generally

The payroll factor of the apportionment formula for each trade or business of the taxpayer shall include the total amount paid by the taxpayer in the regular course of its trade or business for compensation during the tax year. Leased employees' salaries should be included in the payroll factor of the taxpayer which pays the salaries and issues the W-2 forms.

The total amount paid to employees is determined upon the basis of the taxpayer's accounting method. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid. Notwithstanding the taxpayer's method of accounting, compensation paid to employees may, at the election of the taxpayer, be included in the payroll factor by use of the cash method if the taxpayer is required to report such compensation under that method for unemployment compensation purposes.

The compensation of any employee on account of activities which are connected with the production of nonbusiness income shall be excluded from the payroll factor.

The term "compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for their personal services. Payments made to an independent contractor or any other person not properly classifiable as an employee are excluded. Only amounts paid directly to employees are included in the payroll factor. Amounts considered "paid directly" include the value of board, rent, housing, lodging, and other benefits or services furnished to employees by the taxpayer in return for personal services, provided that such amounts constitute income to the recipient under the federal Internal Revenue Code. For those employees employed in foreign countries, the determination of whether such benefits or services would constitute income to the employees shall be made as though such employees were subject to the federal Internal Revenue Code.

The term "employee" means any officer of a corporation, or any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee. Generally, a person will be considered to be an employee if he is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act; except that, since certain individuals are included within the term "employee" in the Federal Insurance

Contributions Act who would not be employees under the usual common-law rules, it may be established that a person who is included as an employee for purposes of the Federal Insurance Contributions Act is not an employee for purposes of calculating the payroll factor.

The denominator of the payroll factor is the total compensation paid everywhere during the tax year. Accordingly, compensation paid to employees whose services are performed entirely in a state where the taxpayer is protected from taxation, for example, by 15 U.S.C. §381, is included in the denominator of the payroll factor.

2.26-51-713 Consistency

If the taxpayer departs from or modifies the treatment of compensation paid which has been used in returns for prior years, the taxpayer shall disclose in its Arkansas return for the current year the nature and extent of the modification.

If the returns filed by the taxpayer with all states to which the taxpayer reports are not uniform in the treatment of compensation paid, the taxpayer shall disclose in its Arkansas return the nature and extent of the variance.

3.26-51-713 Numerator

The numerator of the payroll factor is the total amount paid in Arkansas during the tax period by the taxpayer for compensation.

26-51-715 SALES FACTOR

1.26-51-715 Sales Factor Generally

The term "sales" means all gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business. The following are rules for determining "sales" in various situations:

1. In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods or products, "sales" includes all gross receipts from the sales of such goods or products (or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax year) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. "Gross receipts" for this purpose means gross sales less returns and allowances, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales. Federal and state excise taxes (including sales taxes) shall be included as part of such receipts if the taxes are

passed on to the buyer or included as part of the selling price of the product.

2. In the case of cost plus fixed fee contracts, such as the operation of a government-owned plant for a fee, "sales" includes the entire reimbursed cost plus the fee.
3. In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency or the performance of equipment service contracts or research and development contracts, "sales" includes the gross receipts from the performance of such services, including fees, commissions, and similar items.
4. In the case of a taxpayer engaged in renting real or tangible property, "sales" includes the gross receipts from the rental, lease, or licensing the use of the property.
5. In the case of a taxpayer engaged in the sale, assignment, or licensing of intangible personal property such as patents and copyrights, "sales" includes the gross receipts therefrom.
6. If a taxpayer derives receipts from the sale of equipment used in its business, those receipts constitute sales. For example, a truck express company owns a fleet of trucks and sells its trucks under a regular replacement program. The gross receipts from the sales of the trucks are included in the sales factor.

2.26-51-715 Exceptions

The following special rules are established with respect to the sales factor of the apportionment formula:

1. Where substantial amounts of gross receipts arise from an occasional sale of a fixed asset used in the regular course of the taxpayer's trade or business, those gross receipts shall be excluded from the sales factor if such receipts will materially distort the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded.
2. Where the income producing activity with respect to business income from intangible personal property can be readily identified, the income is included in the denominator of the sales factor and, if the income producing activity occurs in Arkansas, in the numerator of the sales factor as well. For example, usually the income producing activity can be readily identified with respect to interest income received on deferred payments

on sales of tangible property and income from the sale, licensing or other use of intangible personal property.

Where business income from intangible property cannot readily be attributed to any particular income producing activity of the taxpayer, the income cannot be assigned to the numerator of the sales factor for any state and shall be excluded from the denominator of the sales factor. For example, where business income in the form of dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures or government securities results from the mere holding of the intangible personal property by the taxpayer, the dividends and interest shall be excluded from the denominator of the sales factor.

3.26-51-715 Consistency

If the taxpayer departs from or modifies the basis for excluding or including gross receipts in the sales factor used in returns for prior years, the taxpayer shall disclose in its Arkansas return for the current year the nature and extent of the modification.

If the returns filed by the taxpayer with all states to which the taxpayer reports are not uniform in the inclusion or exclusion of gross receipts, the taxpayer shall disclose in its Arkansas return the nature and extent of the variance.

4.26-51-715 Numerator

The numerator of the sales factor shall include gross receipts attributable to Arkansas and derived by the taxpayer from transactions and activity in the regular course of its trade or business. All interest income, service charges, carrying charges, or time-price differential charges incidental to such gross receipts shall be included regardless of (1) the place where the accounting records are maintained or (2) the location of the contract or other evidence of indebtedness.

26-51-717 SALES FACTOR

1.26-51-717 Other than Tangible Personal Property

Gross receipts from transactions other than sales of tangible personal property are attributed to Arkansas if:

1. The income producing activity is performed entirely within Arkansas; or
2. The income producing activity is performed both inside and outside of Arkansas, in which event the portion of income reportable to Arkansas shall be the percentage that is used in the formula for apportioning income to

Arkansas during the year of the sale.

The term "income producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer, or by anyone acting on the taxpayer's behalf, in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Accordingly, income producing activity includes, but is not limited to, the following:

1. The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service;
2. The sale, rental, leasing, licensing or other use of real property;
3. The rental, leasing, licensing or other use of tangible personal property; or
4. The sale, licensing or other use of intangible personal property.

The mere holding of intangible personal property is not, of itself, an income producing activity.

26-51-718 MODIFICATION OF APPORTIONMENT AND ALLOCATION

1.26-51-718(d) Construction Contractors

The following special rules are established with respect to the apportionment of income of construction contractors:

When a taxpayer uses the percentage of completion method of accounting for long-term contracts and has income from sources both inside and outside of Arkansas, the amount of business income derived from such long-term contracts from sources within Arkansas shall be determined pursuant to this regulation. A "long-term" construction contract covers a period in excess of one (1) year from the date of execution of the contract to the date on which the contract is finally completed.

Business income is apportioned to Arkansas by a three-factor formula consisting of property, payroll and sales for all construction. The total of the property plus payroll plus two times the sales percentage is divided by four to determine the apportionment percentage. The apportionment percentage is then applied to business income to determine the amount apportioned to Arkansas.

Percentage of Completion Method. Under this method of accounting for long-term contracts, the amount to be included each year as business income from each contract is the amount by

which the gross contract price (which corresponds to the percentage of the entire contract which has been completed during the tax year) exceeds all expenditures made during the tax year in connection with the contract. In so doing, account must be taken of the material and supplies on hand at the beginning and end of the tax year for use in each such contract.

Example:

A taxpayer using the percentage of completion method of accounting for long-term contracts entered into a long-term contract to build a structure for \$9,000,000. The contract allowed three years for completion and, as of the end of the second income year, the taxpayer's books of account (kept on the accrual method) disclosed the following:

	<u>Receipts</u>	<u>Expenditures</u>
End of 1st income year	\$2,500,000	\$2,400,000
End of 2nd income year	4,500,000	4,100,000
Totals	\$7,000,000	\$6,500,000

In computing the above expenditures, consideration was given to material and supplies on hand at the beginning and end of each tax year. It was estimated that the contract was 30% completed at the end of the first tax year and 80% completed at the end of the second tax year. The amount to be included as business income for the first tax year is \$300,000 (30% of \$9,000,000 or \$2,700,000 less expenditures of \$2,400,000 equals \$300,000). The amount to be included as business income for the second tax year is \$400,000 (50% of \$9,000,000 or \$4,500,000 less expenditures of \$4,100,000 equals \$400,000).

Property Factor. In general the numerator and denominator of the property factor shall be determined as set forth in ACA 26-51-710 to 26-51-712. However, the following special rules also apply:

(A) The average value of the taxpayer's cost (including materials and labor) of construction in progress, to the extent that such costs exceed progress billings (accrued or received, depending on whether the taxpayer is on the accrual or cash basis for keeping its accounts) shall be included in the denominator of the property factor. The value of any such construction costs attributable to construction projects in Arkansas shall be included in the numerator of the property factor.

Example 1: Taxpayer commenced a long-term construction project in Arkansas as of the beginning of a given year. By the end of its second year, its equity in the costs of production to be reflected in the numerator and denominator of its property factor for such year is computed as follows:

	1st Year		2nd Year	
	Beginning	Ending	Beginning	Ending
Construction Costs -0-		\$1,000,000		
Progress billings		<u>- 600,000</u>		
Balance 12/31-01/01		\$400,000	\$400,000	
Construction Costs- Total from beginning of project				\$5,000,000
Progress billings- Total from beginning of project				<u>\$4,000,000</u>
Balance 12/31				\$1,000,000
Balance beginning of year				<u>\$ 400,000</u>
Total				\$1,400,000
Average - One-half (1/2) of value used in property factor				\$ 700,000

NOTE: It may be necessary to use monthly averages if yearly averages do not properly reflect the average value of the taxpayer's equity. See ACA 26-51-712.

Example 2: Same facts as in Example 1, except that progress billings exceeded construction costs. No negative value for the taxpayer's equity in the construction project is shown in the property factor.

(B) Rent paid for the use of equipment directly attributable to a particular construction project is included in the property factor at eight times the net annual rental rate even though such rental expense may be capitalized into the cost of construction.

Payroll Factor. In general, the numerator and denominator of the payroll factor shall be determined as set forth in ACA 26-51-713 and 26-51-714. However, the following special rules also apply:

(A) Compensation paid to employees which is attributable to

a particular construction project is included in the payroll factor even though capitalized into the cost of construction.

(B) Compensation paid to employees who perform their services in a state to which their employer does not report them for unemployment tax purposes shall be attributed to the state in which the services are performed.

Example: A taxpayer engaged in a long-term contract in Arkansas sends several key employees to Arkansas to supervise the project. The taxpayer, for unemployment tax purposes, reports these employees to another state where the main office is maintained and where the employees' reside. For payroll factor purposes, the compensation is assigned to the numerator of Arkansas.

Sales Factor. In general, the numerator and denominator of the sales factor shall be determined as set forth in ACA 26-51-715 to 26-51-717. However, the following special rules also apply:

(A) Gross receipts derived from the performance of a contract are attributable to Arkansas if the construction project is located in Arkansas. If the construction project is located both inside and outside of Arkansas, the gross receipts attributable to Arkansas are based upon the ratio which construction costs for the project in Arkansas incurred during the tax year bear to the total construction costs for the entire project incurred during the tax year.

Example 1: A construction project was undertaken in Arkansas by a calendar year taxpayer. The following gross receipts (progress billings) were derived from the contract during the three tax years that the contract was in progress.

	<u>1st Year</u>	<u>2nd Year</u>	<u>3rd Year</u>
Gross receipts	\$1,000,000	\$4,000,000	\$3,000,000

The gross receipts to be reflected in both the numerator and denominator of the sales factor for each of the three years are the amounts shown.

Example 2: A taxpayer contracts to build a dam on a river at a point which lies half within Arkansas and half within another state. During the taxpayer's first tax year, construction costs in Arkansas were \$2,000,000. Total construction costs for the project during the tax year were \$3,000,000. Gross receipts (progress billings) for the year were \$2,400,000. Accordingly, gross receipts of \$1,600,000 ($\$2,000,000 / \$3,000,000 \times \$2,400,000$) are included in the numerator of the sales factor.

(B) The sales factor includes only that portion of the gross contract price which corresponds to the percentage of the entire contract which was completed during the tax year.

Example: A taxpayer entered into a long-term construction contract. At the end of its current tax year (the second since starting the project), it estimated that the project was 30% completed. The bid price for the project was \$9,000,000 and it had received \$2,500,000 from progress billings as of the end of its current tax year. The amount of gross receipts to be included in the sales factor for the current tax year is \$2,700,000 (30% of \$9,000,000), regardless of whether the taxpayer uses the accrual method or the cash method of accounting for receipts and disbursements.

2.26-51-718(d) Television and Radio Broadcasting

The following special rules are established with respect to the apportionment of income from television and radio broadcasting by a broadcaster that is subject to income tax in both Arkansas and in one or more other states.

When a taxpayer in the business of broadcasting film or radio programming, whether through the public airwaves, by cable, direct or indirect satellite transmission or any other means of communication, either through a network (including owned and affiliated stations) or through an affiliated, unaffiliated or independent television or radio broadcasting station, has income from sources both inside and outside of Arkansas the amount of business income from sources within Arkansas shall be determined pursuant to ACA 26-51-702 to 26-51-718 and the regulations issued thereunder, except as modified by this regulation.

Definitions. The following definitions apply to the terms contained in this regulation.

(i) "Film" or "film programming" means any and all performances, events or productions telecast on television, including but not limited to news, sporting events, plays, stories or other literary, commercial, educational or artistic works, through the use of video tape, disc or any other type of format or medium.

Each episode of a series of films produced for television shall constitute a separate "film" notwithstanding that the series relates to the same principal subject and is produced during one or more tax periods.

(ii) "Outer-jurisdictional property" means certain types of tangible personal property, such as orbiting satellites, undersea transmission cables and the like, that are owned or rented by the taxpayer and used in the business of telecasting or broadcasting, but which are not physically located in any particular state.

(iii) "Radio" or "radio programming" means any and all performances, events or productions broadcast on radio, including but not limited to news, sporting events, plays, stories or other literary, commercial, educational or artistic works, through the use of an audio tape, disc or any other format or medium.

Each episode of a series of radio programming produced for radio broadcast shall constitute a separate "radio programming" notwithstanding that the series relates to the same principal subject and is produced during one or more tax periods.

(iv) "Release" or "in release" means the placing of film or radio programming into service. A film or radio program is placed into service when it is first broadcast to the primary audience for which the program was created. Thus, for example, a film is placed in service when it is first publicly telecast for entertainment, educational, commercial, artistic or other purpose. Each episode of a television or radio series is placed in service when it is first broadcast. A program is not placed in service merely because it is completed and therefore in a condition or state of readiness and availability for broadcast or merely because it is previewed to prospective sponsors or purchasers.

(v) "Rent" shall include license fees or other payments or consideration provided in exchange for the broadcast or other use of television or radio programming.

(vi) A "subscriber" to a cable television system is the individual residence or other outlet which is the ultimate recipient of the transmission.

(vii) "Telecast" or "broadcast" (sometimes used interchangeably with respect to television) means the transmission of television or radio programming, respectively, by an electronic or other signal conducted by radio waves or microwaves or by wires, lines, coaxial cables, wave guides, fiber optics, satellite transmissions directly or indirectly to viewers and listeners or by any other means of communications.

Apportionment of Business Income

The property factor shall be determined in accordance with ACA 26-51-710 to 26-51-712, the payroll factor in accordance with ACA 26-51-713 and 26-51-714, and the sales factor in accordance with ACA 26-51-715 to 26-51-717, except as modified by this regulation.

The Property Factor

In the case of rented studios, the net annual rental rate shall include the amount of the basic or flat rental charge by the studio for the use of a stage or other permanent equipment

(such as sound recording equipment). The net annual rental rate shall also include the rental charges for any additional equipment rented from other sources or from the studio which is not covered in the basic or flat rental charge and **which is used for one (1) week or longer** (even though rented on a day-to-day basis). Lump-sum net rental payments for a period which encompasses more than a single tax year shall be assigned ratably over the rental period.

No value or cost attributable to any outer-jurisdictional film or radio programming property shall be included in the property factor at any time.

Property Factor Denominator

All real property and tangible personal property (other than outer-jurisdictional and film or radio programming property), whether owned or rented, which is used in the business shall be included in the denominator of the property factor.

Audio or video cassettes, discs or similar medium containing film or radio programming and intended for sale or rental by the taxpayer for home viewing or listening shall be included in the property factor at the mediums' original cost. To the extent that the taxpayer licenses or otherwise permits others to manufacture or distribute such cassettes, discs or other medium containing film or radio programming for home viewing or listening, the value of such cassettes, discs or other medium shall include the license, royalty or other fees received by the taxpayer capitalized at a rate of eight times the gross receipts derived therefrom during the tax year.

Outer-jurisdictional, film and radio programming property shall be excluded from the denominator of the property factor.

Property Factor Numerator

With the exception of outer-jurisdictional, film and radio programming property, all real and tangible personal property owned or rented by the taxpayer and used in Arkansas during the tax year shall be included in the numerator of the property factor as provided in ACA 26-51-710 to 26-51-712.

Outer-jurisdictional, film and radio programming property shall be excluded from the numerator of the property factor.

Example: XYZ Television Co. has a total value of all of its property everywhere of \$500,000,000, including a satellite valued at \$50,000,000 that was used to telecast programming into Arkansas and \$150,000,000 in film property of which \$1,000,000's worth was located in Arkansas the entire year. The total value of real and tangible personal property, other than film programming property, located in Arkansas for the entire tax year was valued at \$2,000,000. Movable and mobile property was

determined to have a value of \$4,000,000 and such movable and mobile property was used in Arkansas for 100 days.

The total value of property to be attributed to Arkansas would be determined as follows:

Value of property permanently located within Arkansas:	\$2,000,000
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Value of mobile and movable property (100/365 or .2739 x \$4,000,000):	<u>\$1,095,600</u>
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Total value of property to be included in Arkansas' property factor numerator (outer-jurisdictional and film property excluded):	\$3,095,600
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Total value of property to be used in the denominator (\$500,000,000-\$200,000,000):	\$300,000,000
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Total property factor (\$3,095,600/\$300,000,000):	.01031867
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The Payroll Factor

Payroll Factor Denominator

The denominator of the payroll factor shall include all compensation, including residual and profit participation payments, paid to employees during the tax year, including that paid to directors, actors, newscasters and other talent in their status as employees.

Payroll Factor Numerator

Compensation for all employees shall be attributed to Arkansas as determined by the provisions of ACA 26-51-713 and 26-51-714.

The Sales Factor

Sales Factor Denominator

The denominator of the sales factor shall include the total gross receipts derived by the taxpayer from transactions and activity in the regular course of the taxpayer's trade or business.

Sales Factor Numerator

The numerator of the sales factor shall include all gross receipts of the taxpayer from sources within Arkansas, including, but not limited to, the following:

1. Gross receipts, including advertising revenue, from

television film or radio programming in release to or by television and radio stations located in Arkansas;

2. Gross receipts, including advertising revenue, from television film or radio programming in release to or by a television station(independent or unaffiliated) or network of stations for broadcast shall be attributed to Arkansas in the ratio (hereafter "audience factor") that the audience for such station (or owned and affiliated stations in the case of networks) located in Arkansas bears to the total audience for such station (or owned and affiliated stations in the case of networks).

The audience factor for television or radio programming shall be determined by the ratio that the taxpayer's Arkansas viewing or listening audience bears to its total viewing or listening audience. Such audience factor shall be determined either by reference to the books and records of the taxpayer or by reference to published rating statistics, provided the method used by the taxpayer is consistently used from year to year and from state to state for such purpose and fairly represents the taxpayer's activity in Arkansas;

3. Gross receipts from film programming in release to or by a cable television system shall be attributed to Arkansas in the ratio(hereafter "audience factor") that the subscribers for such cable television system located in Arkansas bears to the total subscribers of such cable television system. If the number of subscribers cannot be accurately determined from the books and records maintained by the taxpayer, such audience factor ratio shall be determined on the basis of the applicable year's subscription statistics located in published surveys, provided that the source selected is consistently used from year to year and from state to state for that purpose; or

4. Receipts from the sale, rental, licensing or other disposition of audio or video cassettes, discs, or similar medium intended for home viewing or listening shall be included in the sales factor as provided in ACA 26-51-716 and 26-51-717.

3.26-51-718(d) Publishing

The following special rules are established with respect to the apportionment of income derived from the publishing, sale, licensing or other distribution of books, newspapers, magazines, periodicals, trade journals or other printed material.

In General. Except as specifically modified by this regulation, when a taxpayer in the business of publishing, selling, licensing or distributing newspapers, magazines, periodicals, trade journals or other printed material has income from sources both inside and outside of Arkansas, the amount of business income from sources within Arkansas from such business

activity shall be determined pursuant to ACA 26-51-702 to 26-51-718.

Definitions. The following definitions apply to the terms contained in this regulation:

(i) "Outer-jurisdictional property" means certain types of tangible personal property, such as orbiting satellites, undersea transmission cables and the like, that are owned or rented by the taxpayer and used in the business of publishing, licensing, selling or otherwise distributing printed material, but which are not physically located in any particular state.

(ii) "Print or printed material" includes, without limitation, the physical embodiment or printed version of any thought or expression including, without limitation, a play, story, article, column or other literary, commercial, educational, artistic or other written or printed work. Printed material may take the form of a book, newspaper, magazine, periodical, trade journal or any other form of printed matter and may be contained on any medium or property.

(iii) "Purchaser" and "Subscriber" means the individual, residence, business or other outlet which is the ultimate or final recipient of the print or printed material. Neither of such terms shall include a wholesaler or other distributor of print or printed material.

(iv) "Terrestrial facility" shall include any telephone line, cable, fiber optic, microwave, earth station, satellite dish, antennae or other relay system or device that is used to receive, transmit, relay or carry any data, voice, image or other information that is transmitted from or by any outer-jurisdictional property to the ultimate recipient thereof.

Apportionment of Business Income

The Property Factor

Property Factor Denominator

All real and tangible personal property, whether owned or rented, which is used in the taxpayer's business shall be included in the denominator of the property factor. However, outer-jurisdictional property shall not be included in the property factor's denominator.

Property Factor Numerator

All real and tangible personal property owned or rented by the taxpayer and used in Arkansas during the tax year shall be included in the numerator of the property factor. However, outer-jurisdictional property owned or rented by the taxpayer and used in Arkansas during the tax year shall be excluded from the

numerator of the property factor.

Example: ABC Newspaper Co. owns a total of \$400,000,000 of property everywhere and, in addition, it owns and operates a communication satellite for the purpose of sending news articles to its printing plant in Arkansas, as well as for communicating with its printing plants, news bureaus, employees and agents located in other states and throughout the world. The total value of its real and tangible personal property that was permanently located in Arkansas for the entire tax year was valued at \$3,000,000. The total original cost of the satellite is \$100,000,000 for the tax year. The taxpayer's mobile property that was used partially within Arkansas, consisting of 40 delivery trucks, was determined to have an original cost of \$4,000,000. The delivery trucks were used in Arkansas for 95 days.

The total value of property to be attributed to Arkansas would be determined as follows:

Value of property permanently located within Arkansas:	\$3,000,000
Value of mobile property (95/365 or .260274 x \$4,000,000):	<u>\$1,041,096</u>
Total value of property attributable to Arkansas:	\$4,041,096
Total property factor % (\$4,041,096/\$400,000,000):	1.010274%

The Payroll Factor

The payroll factor shall be determined according to ACA 26-51-713 and 26-51-714 and the regulations promulgated thereunder.

The Sales Factor

Sales Factor Denominator

The denominator of the sales factor shall include the total gross receipts derived by the taxpayer from transactions and activity in the regular course of the taxpayer's trade or business.

Sales Factor Numerator

The numerator of the sales factor shall include all gross receipts of the taxpayer from sources within Arkansas, including, but not limited to, the following:

1. Gross receipts derived from the sale of tangible

personal property, including printed materials, delivered or shipped to a purchaser or a subscriber in Arkansas;

2. Except as provided in paragraph 3 below, gross receipts derived from advertising and the sale, rental or other use of the taxpayer's customer lists or any portion thereof shall be attributed to Arkansas as determined by the taxpayer's "circulation factor" during the tax year. The circulation factor shall be determined for each individual publication by the taxpayer of printed material containing advertising and shall be equal to the ratio that the taxpayer's Arkansas circulation to purchasers and subscribers of its printed material bears to its total circulation to purchasers and subscribers everywhere.

The circulation factor for an individual publication shall be determined by reference to the rating statistics as reflected in such sources as Audit Bureau of Circulations or other comparable sources, provided that the source selected is consistently used from year to year and from state to state for such purpose. If none of the foregoing sources are available, or, if available, none is in form or content sufficient for such purposes, then the circulation factor shall be determined from the taxpayer's books and records;

3. When specific items of advertisements can be shown, upon clear and convincing evidence, to have been distributed solely to a limited regional or local geographic area in which Arkansas is located, the taxpayer may petition, or the Department may require, that a portion of such receipts be attributed to the sales factor numerator of Arkansas on the basis of a regional or local geographic area circulation factor and not upon the basis of the circulation factor provided by paragraph 2 above. Such attribution shall be based upon the ratio that the taxpayer's circulation to purchasers and subscribers located in Arkansas of the printed material containing such specific items of advertising bears to its total circulation of such printed material to purchasers and subscribers located within such regional or local geographic area. This alternative attribution method shall be permitted only upon the condition that such receipts are not double counted or otherwise included in the numerator of any other state; or

4. In the event that the purchaser or subscriber is the United States Government or that the taxpayer is not taxable in a certain other state, the gross receipts from all sources, including the receipts from the sale of printed material, from advertising, and from the sale, rental or other use of the taxpayer's customer lists, or any portion thereof that would have been attributed by the circulation factor to the numerator of the sales factor for such other state, shall be included in the numerator of the sales factor of Arkansas if the printed material or other property is shipped from an office, store, warehouse, factory, or other place of storage or business located in Arkansas.

4.26-51-718(d) Airlines

Every taxpayer engaged in the business of transportation of passengers or freight by air both inside and outside of Arkansas shall determine its net income subject to Arkansas income tax by taking that portion of total net operating revenue that the total passenger and freight receipts in Arkansas bears to total receipts from both inside and outside of Arkansas.

Example: Airline Apportionment

Total Passenger & Freight Receipts	\$50,000,000
Arkansas Passenger & Freight Receipts	\$10,000,000
Operating Income	\$ 2,000,000
Operating Expenses	\$ 1,500,000
Net Operating Income	\$ 500,000

$(\$10,000,000 \div \$50,000,000) \times \$500,000 = \$100,000$ Ark. taxable income

5.26-51-718(d) Bus Lines and Trucking Companies

Every taxpayer engaged in the business of operating a bus line or trucking company both inside and outside of Arkansas shall determine its net income subject to Arkansas income tax by taking that portion of the total net operating income that the total number of miles operated within Arkansas bears to the total system miles.

Example: XYZ Trucking Company had federal taxable income of \$1,000,000. It operated 10,000,000 total miles and 500,000 miles in Arkansas. The Arkansas apportionment factor is 500,000 divided by 10,000,000 or 5% and, assuming no adjustments to federal taxable income are necessary to arrive at apportionable income, Arkansas taxable income is \$1,000,000 X 5% or \$50,000.

6.26-51-718(d) Pipelines

Every taxpayer operating a pipeline for the transportation of oil or gas both inside and outside of Arkansas shall apportion its net operating income attributable to Arkansas by multiplying the net income by a fraction, the numerator of which is the property factor plus the payroll factor plus double the sales factor and the denominator of which is four.

Property factor - The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and personal property owned or rented and used in Arkansas and the denominator of which is the average value of all the taxpayer's real and personal property owned or rented during the tax year.

Average value of the property owned by the taxpayer means the

average of the original cost of the property at the beginning and ending of the tax year. Rental property is valued at eight times the net annual rental.

Payroll factor - The payroll factor is a fraction, the numerator of which is compensation paid for services performed entirely within Arkansas plus a ratable part of compensation paid for services performed both inside and outside of Arkansas, based on the total number of barrel or unit miles in Arkansas, divided by the total barrel or unit miles system wide and the denominator of which is the total compensation paid everywhere during the tax year.

Sales factor - The sales factor is a fraction, the numerator of which is the total sales within Arkansas plus a proportionate part of system revenue earned in Arkansas determined on the basis of the total barrel or unit miles within Arkansas to the total barrel or unit miles in the system during the tax year, and the denominator of which is the total revenue everywhere during the tax year.

Example: Pipeline Company

Property Factor:

Total Property	\$1,000,000
Arkansas Property	\$ 100,000

$(\$100,000 \div \$1,000,000) = 10.000000\%$

Payroll Factor: (Assuming one pipeline and constant volume)

Total Payroll	\$ 200,000
Multistate Payroll	\$ 100,000
Arkansas Payroll	\$ 20,000
Total Barrels	500,000
Arkansas Barrels	50,000
Total Pipeline Miles	1,000
Arkansas Pipeline Miles	100

$\$20,000 + ([50,000 \times 100 \text{ miles}] \div [500,000 \times 1,000 \text{ miles}] \times \$100,000) \div \$200,000 = (\$20,000 + \$1,000) \div \$200,000 = 10.500000\%$

Sales Factor:

Total Sales	\$1,000,000
Arkansas Sales	\$ 200,000
Multistate Sales	\$ 500,000
Barrel Miles Ratio (from the payroll factor)	.01

$\$200,000 + (.01 \times \$500,000) \div \$1,000,000 = 20.500000\% \times 2 = 41.000000\%$

Operating Income	\$ 300,000
Operating Expense	\$ 200,000
Net Operating Income	\$ 100,000

Apportionment Factor:

$10\% \text{ (property)} + 10.5\% \text{ (payroll)} + 41\% \text{ (sales)} = 61.5\%$

$61.500000\% \div 4 = 15.375000\%$

$\$100,000 \text{ (net operating income)} \times 15.375000\% = \$15,375$

26-51-802 PARTNERSHIP RETURNS

1.26-51-802(b) Corporations with Partnership Interest

Any taxpayer with an interest in a partnership which has gross income from sources within Arkansas must directly allocate the partnership's Arkansas income to Arkansas, rather than include partnership income and apportionment factors in the taxpayer's apportionment formula.

Example:

Partnership Total Income	\$100,000
Partnership Income Directly Allocated to Arkansas	\$50,000

Corporation A's Ownership	10%
Corporation B's Ownership	90%

Corporation A:	$\$50,000 \times .10 = \$5,000$
Corporation B:	$\$50,000 \times .90 = \$45,000$

The amount of partnership income directly allocated to Arkansas will be entered on page 1 of the "Other Income" line or on page 2, Schedule A, Part C, "Direct Income Allocated To Arkansas" line of Form AR1100CT.

If the taxpayer's operations are multistate, all partnership income must be deducted on Schedule A, Part A, "Deduct Adjustments" line. The partnership's Arkansas income should then be entered on Schedule A, Part C, "Direct Income Allocated To Arkansas" line of Form AR1100CT.

26-51-804 CORPORATION RETURNS

1.26-51-804(a) Federal Employer Identification Number - FEIN

Every corporation income tax return, information return, amended

return, report, declaration of estimated tax return or claim for refund must include a correct Federal Employer Identification Number ("FEIN"). FEINs are assigned by the Internal Revenue Service.

1.26-51-804(d) Bankruptcy, Dissolution and Receivership

A receiver, assignee or trustee operating the property or business of a taxpayer, must file an income tax return for such taxpayer (Form AR1100CT) for each year or part of a year during which the fiduciary is in control. Because the powers and functions of the taxpayer are suspended and the taxpayer's property and business are for the time being in the custody of a fiduciary, the fiduciary stands in the place of the taxpayer's officers and is required to perform all the duties and assume all the liabilities which would normally rest with the taxpayer's officers were they in control. A fiduciary in charge of only part of the property of a taxpayer, such as a receiver in mortgage foreclosure proceedings involving only a small portion of the taxpayer's property, need not file an Arkansas corporation income tax return on behalf of the taxpayer.

26-51-805 CONSOLIDATED CORPORATE RETURNS

1.26-51-805 Generally

If two or more members of a federal consolidated group file an Arkansas consolidated return, all members who have income from sources within Arkansas must join in the filing of the Arkansas consolidated return. If a corporation is acquired by a parent corporation which has members that file a consolidated Arkansas return, the acquired corporation must join in the filing of the Arkansas consolidated return. If members of an Arkansas consolidated group are acquired by a new parent corporation, they may elect to file separate returns if the acquiring parent has no members who file an Arkansas consolidated return.

1.26-51-805(a)(1) Eligible Members

All eligible members of a federal affiliated group that join in the filing of a federal consolidated income tax return may elect to file an Arkansas consolidated income tax return. However, only those eligible members that have gross income from sources within Arkansas may join in the filing of an Arkansas consolidated income tax return. A member of a consolidated group which joins or leaves the group during a tax year must compute its Arkansas taxable income based on the period for which it was a member of the group.

1.26-51-805(d)(1) Change of Ownership

If a corporation has a change of ownership under IRC Section 1501 et seq., it must submit a statement outlining the specific changes of ownership which qualify to file a federal consolidated return under Section 1501 et seq. with the separate returns of any affected members and with the consolidated return of the remaining members if applicable.

1.26-51-805(e) Allocation of Tax Credits

If any member of a consolidated group has an income tax credit, the credit may be applied to the group's consolidated income, regardless of whether or not the member earning the credit had taxable income.

If a member of a consolidated group which earns a credit leaves the group, the credit will first be applied to the last consolidated return in which the member participated. Any remaining balance will be applied to the next return of the member which earned the credit.

If a corporation with an income tax credit merges into another corporation, the credit may be claimed by the surviving corporation only when the ownership of both the acquired and acquiring corporations is substantially the same and at least 80% of the voting stock is owned by the same person or, prior to the acquisition, the acquiring corporation owned at least 80% of the voting stock of the acquired corporation.

1.26-51-805(f) Separate Computation of Taxable Income or Loss

Corporations filing a consolidated return and which select Filing Status "4" must complete a **separate** Form AR1100CT for each member with gross income from sources within Arkansas (including an Arkansas Schedule A if multistate). These separate returns should reflect taxable income before any allowable inter-company eliminations and adjustments. Each member's separate Form AR1100CT must be consolidated on a group Form AR1100CT which should also reflect taxable income before any allowable inter-company eliminations and adjustments. In addition, a complete copy of the federal return must be attached. A schedule listing each allowable inter-company elimination and adjustment, identifying the entity by FEIN to which it applies, must be submitted if this information is not clearly shown in the federal return.

Income tax will be computed on the Arkansas consolidated taxable income reported on the group Form AR1100CT.

Contribution limitations are computed on a separate corporation basis. In the case of multistate corporations, the contribution limitation is computed based on the total apportionable income as

shown on Arkansas Schedule A, Part A of Form AR1100CT.

In place of a separate Form AR1100CT for each member of the consolidated group, the taxpayer may submit a schedule showing the separate calculation of income. However, each corporation shown on the schedule must be identified by a FEIN and corporate name.

EXAMPLE 1: The taxpayer uses the cash basis of reporting income.

	<u>FEIN # Corp A</u>	<u>FEIN # Corp B</u>	<u>Eliminating Entry</u>	<u>Federal Return Total</u>
Total Income	\$100,000	\$200,000	-0-	\$300,000
Total Deduction (105,000) (w/o contribution)		(125,000)	-0-	(230,000)
Contributions	5,000	10,000	(8,000)	7,000
AR State Taxes (prior year)	1,000	500	--	--

Apport. Factor 100.000000% 10.000000%

CONTRIBUTION LIMITATION CALCULATION

Income	\$100,000	\$200,000
Deductions	(105,000)	(125,000)
Taxes	<u>1,000</u>	<u>500</u>
	(\$4,000)	\$75,500

Contribution Limit -0- \$75,500 X 10% = \$7,550

TAXABLE INCOME CALCULATION

Income	\$100,000	\$200,000
Deductions	<u>*(104,000)</u>	<u>** (132,050)</u>
	(\$4,000)	\$67,950
Apport. Factor	<u>100.000000%</u>	<u>10.000000%</u>

AR Taxable Income(\$4,000) \$6,795

AR Consolidated

Taxable Income (\$4,000) + \$6,795 = \$2,795

*\$105,000 - \$1,000 Ark. Income Tax + \$-0- contributions

**\$125,000 - \$500 Ark. Income Tax + \$7,550 contributions

Corporation A and B file a consolidated return for federal and state tax purposes. The contribution deduction is calculated on a consolidated basis for federal income tax purposes and would be \$7,000.

The contribution deduction is calculated on an individual

corporation basis for state income tax purposes and would be \$7,550 as calculated above. The calculation is computed prior to apportioning. Any nondeductible amount can be carried forward for up to five (5) years.

EXAMPLE 2:

	<u>Corp X</u>	<u>Corp Y</u>	<u>Corp Z</u>	<u>Federal Return Total</u>
Total Income	\$100,000	\$1,000,000	\$500,000	\$1,600,000
Total Deductions	111,000	900,000	520,000	1,530,000
Fed. Taxable Inc. (11,000)		100,000	(20,000)	69,000
Apport. Factor	100.000000%	10.000000%	50.000000%	
Contributions	500	5,000	1,000	6,500

CORP X AR1100CT

Total Income	\$ 100,000	
Less: Total Deductions	<u>(110,500)</u>	
Arkansas Taxable Income		(\$ 10,500)

CORP Y AR1100CT

Federal Taxable and Apportionable Income	\$ 100,000	
Times: Apport. Factor	<u>X 10.000000%</u>	
Arkansas Taxable Income		\$ 10,000

CORP Z AR1100CT

Federal Taxable Income	(\$ 20,000)	
Plus: Contributions per	<u>+ 1,000</u>	
Federal Return not Deduct- ible in Arkansas		
Apportionable Income	(\$ 19,000)	
Times: Apport. Factor	<u>X 50.000000%</u>	
Arkansas Taxable Income		<u>(\$ 9,500)</u>

Consolidated Arkansas Taxable Income (\$ 10,000)

ARKANSAS NET OPERATING LOSS

	<u>Corp X</u>	<u>Corp Y</u>	<u>Corp Z</u>	<u>Total</u>
Ark. Taxable Income (Loss)	(\$10,500)	\$10,000	(\$ 9,500)	(\$ 10,000)
Offset Income & Losses	\$ 5,250	(\$10,000)	(\$ 4,750)	-0-
Ark. Net Operat- ing Loss	(\$ 5,250)	-0-	(\$ 4,750)	(\$ 10,000)

Corporation X and its subsidiaries file an Arkansas consolidated

return. For federal income tax purposes, the group had taxable income and deducted all contributions in the current year. However, for Arkansas income tax purposes, the two members with losses were unable to deduct contributions because each member must calculate its taxable income separately. Corporation Y is able to deduct contributions because it had income, even though the group has a loss for Arkansas purposes. The unused contributions may be carried forward for up to five (5) years.

2.26-51-805(f) Separate Computation of Taxable Income or Loss

A consolidated net operating loss ("NOL") carryover shall be allowed as a deduction from gross income on the consolidated return of an affiliated group under the following rules:

- (A) Consolidated NOL carryover shall consist of any consolidated net operating losses (as determined under paragraph C) of the group plus any net operating losses incurred by members of the group in separate return years (as defined in paragraph D) which may be carried over under the provisions of ACA 26-51-427. However, a NOL incurred by a member corporation in a separate return limitation year (as defined in paragraph E) shall be subject to the limitation set forth in paragraph B;
- (B) With respect to the limitation on NOL carryovers from separate return limitation years, in the case of a NOL of a member of the group carried forward from a separate return limitation year, the amount of the NOL allowed to be carried to the consolidated return shall not exceed:
 - 1) the income of the member corporation which incurred the loss computed for the consolidated year,

minus
 - 2) the net operating losses attributable to such member which may be carried to the consolidated year arising in tax years prior to the separate return limitation year;
- (C) The consolidated NOL shall include the separate net income or loss of each member corporation separately apportioned or allocated to Arkansas and shall be subject to the NOL adjustments set forth in ACA 26-51-427. NOL deductions shall not be taken into account in computing separate net income or loss;
- (D) "Separate return year" as used in this regulation means a tax year of a corporation for which it files a separate return or for which it joins in the filing of a consolidated return by another group;

- (E) "Separate return limitation year" as used in this regulation means any separate return year of a corporation which was not a member of a group for each day of the tax year. However, a "separate return limitation year" does not apply in the case of a common parent for a consolidated year or to the separate return year of a predecessor of any member if such predecessor was a member of the group for each day of the tax year;
- (F) If a consolidated NOL can carry forward to a separate return year of a corporation which was a member of an affiliated group in the year in which the loss arose, then the portion of the NOL attributable to such corporation shall be apportioned to such corporation under the provisions of paragraph G and shall be a NOL carryover to such separate return year. However, such portions shall not be included in the consolidated NOL carryovers to the equivalent consolidated return year;
- (G) The portion of a consolidated NOL attributable to a member of a group is the consolidated NOL multiplied by a fraction, the numerator of which is the separate NOL of such corporation, and the denominator of which is the sum of the separate net operating losses of all members of the group in the year in which such losses were incurred;
- (H) If a corporation ceases to be a member during a consolidated return year, any consolidated NOL carryover from a prior tax year must first be carried to such consolidated return year even though all or a portion of the consolidated NOL giving rise to the carryover is attributable to the corporation which ceases to be a member. To the extent not absorbed in such consolidated return year, the portion of the consolidated NOL attributable to the corporation ceasing to be a member shall then be carried to the corporation's first separate return year; and
- (I) Complete schedules must be submitted for all net operating losses carried forward to or from consolidated returns. Schedules must contain information to substantiate which corporations incurred net operating losses and the age of the net operating losses. Schedules must also account for all nontaxable income for which adjustments are required to be made to a NOL carryover pursuant to paragraphs A and C and ACA 26-51-427.

The separate taxable income or loss of each member must first be determined as required by ACA 26-51-805(f) and paragraph C. The separate loss of each member is divided by the total losses of all members during the tax year and is then multiplied by the

consolidated net loss. The resulting NOL shall then be subject to nontaxable income and adjustments as set forth in ACA 26-51-427. "Add-backs" should be applied to each member of the group separately. If a member with positive income has nontaxable income, no add-back is necessary since that member will have no NOL carry forward.

A separate return limitation year as defined in paragraph E is a year in which the corporation was not eligible to file a consolidated return with the rest of the group. Net operating losses from a separate return limitation year may not offset income of the entire group but may only be used to offset income of the member which has the separate return limitation year in accordance with paragraph B.

A separate return year is different from a separate return limitation year. A separate return year as defined in paragraph D is a year in which a corporation was eligible to file a consolidated return with the rest of the group but did not do so. Net operating losses from separate return years may offset income of the entire group in accordance with paragraph A.

The NOL of the corporation ceasing to be a member is first applied to the final consolidated return in which it participates. Any remaining NOL is then carried to that corporation's separate returns in subsequent years or is subject to separate return limitation year restrictions if it joins another consolidated group.

EXAMPLE 1:

CALCULATION OF NOL'S WITHIN A CONSOLIDATED GROUP					
	Parent Corporation	Corporation	Corporation	Corporation	Total
	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	
<u>12/94</u> NTI (Loss)	\$ 5,168.00	(\$ 5,198.00)	(\$31,361.00)	\$1,807.00	(\$29,584.00)
		÷	÷		
		<u>(\$36,559.00)</u>	<u>(\$36,559.00)</u>		
Total Income	\$ 6,975.00	= .1422	= .8578		
Total Losses	<u>(36,559.00)</u>	<u>X(29,584.00)</u>	<u>X(29,584.00)</u>		
Group Loss	(\$29,584.00)				
NOL Carry Forward	-0-	(4,207.00)	(25,377.00)	-0-	(29,584.00)
12/94 NOL Claimed 12/95		<u>2,292.00</u>	<u>13,826.00</u>		<u>16,118.00</u>
New NOL Carry forward to 12/96		(1,915.00)	(11,551.00)	-0-	(13,466.00)
Allocation of NOL		(4,207.00)	(25,377.00)		
		÷	÷		
		<u>(29,584.00)</u>	<u>(29,584.00)</u>		
		= .1422	= .8578		
		<u>X 16,118</u>	<u>X 16,118</u>		
		(2,292.00)	(13,826.00)		
<u>12/95</u> NTI (Loss)	1,236.00	(2,035.00)	5,692.00	11,225.00	16,118.00
NOL Allowed	<u>-0-</u>	<u>(2,292.00)</u>	<u>(13,826.00)</u>	<u>-0-</u>	<u>(16,118.00)</u>
Taxable Income	1,236.00	(4,327.00)	(8,134.00)	11,225.00	-0-

12/94 FORMULA: (Entity Loss ÷ Total Loss) X Group Loss = NOL carry forward per entity.

12/95 FORMULA: (Entity Loss ÷ Group NOL) X NTI for current year = Amt. claimed from entity with available NOL.

EXAMPLE 2: Common Parent

Corporation A was a single entity through 1994 and formed a consolidated group when Corporation B was incorporated in 1995. Corporation B was never a part of another group nor did it ever file by itself. Corporation A's 1993 and 1994 NOL is used to offset the 1996 consolidated income from both A and B. The remaining balance of Corporation A's 1994 NOL carry forward is \$36,400 (\$40,000 less \$3,600) and may be used by the consolidated group subject to the five (5) year NOL carry forward provision stated in ACA 26-51-427. This example assumes there are no non-taxable income adjustments for the loss years of 1993, 1994 and 1995.

Consolidated	<u>A</u>	<u>B</u>
<u>Total</u>		
1993 NTI (Loss)	(\$ 5,000)	--
--		
1994 NTI (Loss)	(40,000)	--
--		
1995 NTI (Loss)	(7,000)	(3,000)
(10,000)		
1996 NTI Before NOL	600	8,000
8,600		
A's NOL Allowed from 1993	(5,000)	--
(5,000)		
A's NOL Allowed from 1994	(3,600)	--
(3,600)		
1996 NTI		
-0-		

EXAMPLE 3: Separate Return Year

Corporation A and B are members of a federal consolidated group which filed separate Arkansas returns for 12/94 and 12/95 and a consolidated Arkansas return in 12/96. The 12/94 and 12/95 years are separate return years.

Consolidated	<u>A</u>	<u>B</u>
<u>Total</u>		
12/94 Separate Arkansas	(\$ 5,000)	(\$ 2,000)

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--
Returns Filed
12/95 Separate Arkansas          3,000      ( 3,000)
--
Returns Filed
12/94 NOL Claimed in 12/95      ( 3,000)      -0-
--
12/95 Taxable Income            -0-          ( 3,000)
--
12/96 Consolidated Arkansas      3,000          3,000
6,000
Return Filed
Taxable Income Before NOL
12/94 NOL Claimed in 12/96      ( 2,000)      ( 2,000)
( 4,000)
12/95 NOL Claimed in 12/96      -0-          ( 2,000)
( 2,000)
from Corp. B
12/96 Taxable Income            1,000          ( 1,000)
-0-

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EXAMPLE 4: Separate Return Limitation Year

Corporation A & B filed as separate entities through 1994. On 01/01/95, Corporation A bought 100% of Corporation B. The NOL of Corporation B is limited by the separate return limitation year restrictions and can only offset its own income. This example assumes there are no nontaxable income adjustments for the loss years.

	<u>A</u>	<u>B</u>	<u>Consolidated Total</u>
1993 NTI (Loss)	(\$ 5,000)	(\$10,000)	--
1994 NTI (Loss)	(2,000)	(10,000)	--
1995 NTI (Loss)	10,000	(1,000)	9,000
A's NOL Allowed from 1993	(5,000)	--	(5,000)
A's NOL Allowed from 1994	<u>(2,000)</u>	<u>--</u>	<u>(2,000)</u>
Net Taxable Income (for the 1995 tax year)	\$ 3,000	(\$ 1,000)	\$ 2,000
1996 NTI	5,000	2,000	7,000
B's NOL Allowed from 1993	<u>-0-</u>	<u>(2,000)</u>	<u>(2,000)</u>
Net Taxable Income	\$ 5,000	-0-	\$ 5,000
1997 NTI	2,000	5,000	7,000
B's NOL Allowed from 1993	<u>-0-</u>	<u>(5,000)</u>	<u>(5,000)</u>
Net Taxable Income	\$ 2,000	-0-	\$ 2,000
1998 NTI (Loss)	5,000	(2,000)	\$ 3,000

(No NOL available since B has a loss)

B's NOL Carry forward to 1999

1993 (loss)	Expired
1994 (Loss)	(10,000)*

* (Subject to SEPARATE RETURN LIMITATION YEAR RULE - Can only offset "B" corporation income.)

EXAMPLE 5: Nontaxable Add-Back

Corporation A has \$5,000 of nontaxable interest income.

	<u>A</u>	<u>B</u>	<u>Total</u>
1993 NTI (Loss)	(\$10,000)	\$2,000	(\$8,000)
Corporation B Income	2,000	(2,000)	--
*Nontaxable Add-back	<u>5,000</u>	<u>-0-</u>	<u>5,000</u>
NOL carry forward	(\$ 3,000)	-0-	(\$3,000)

Corporation A has \$6,000 of nontaxable interest income, but the add-back is limited to the loss of the entity earning nontaxable income.

1994 NTI (Loss)	(\$ 5,000)	(\$3,000)	(\$8,000)
*Nontaxable Add-back	<u>5,000</u>	<u>-0-</u>	<u>5,000</u>
NOL carry forward	-0-	(\$3,000)	(\$3,000)

EXAMPLE 6: Member Leaving Group

Corporations A, B, and C filed as a consolidated group through 12/95. On 01/01/96, Corporation C was sold to Corporation D and the NOL of Corporation C is taken to the new group (but limited to SRLY). Corporation D has no NOL carryover.

	<u>A</u>	<u>B</u>	<u>C</u>	<u>Total</u>
1993 NTI (Loss)	(\$5,000)	\$2,000	(\$1,000)	(\$ 4,000)
Gains \$2,000				
Losses <u>(\$6,000)</u>	<u>(6,000)</u>		<u>(6,000)</u>	
Net Loss (\$4,000)	= .8333		= .1667	
	X <u>(4,000)</u>		X <u>(4,000)</u>	
NOL	(\$3,333)	-0-	(\$ 667)	(\$ 4,000)
Allocation of 1993 NOL to 1994	.8333		.1667	
	X <u>(2,000)</u>		X <u>(2,000)</u>	
	(\$1,667)		(\$ 333)	
1994 NTI (Loss)	1,000	(\$3,000)	\$ 4,000	\$ 2,000
NOL From 1993 <u>(1,667)</u>	<u>(\$ 667)</u>	<u>(333)</u>	<u>(\$ 2,000)</u>	-0-
1995 NTI (Loss)	(\$5,000)	(\$ 4,000)	(\$ 1,000)	(\$10,000)

	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>		
NOL Carryover Summary:						
1993	(\$ 1,666)	-0-	(\$ 334)	-0-		
1994	-0-	-0-	-0-	-0-		
1995	(5,000)	(\$ 4,000)	(1,000)	-0-		
	<u>A</u>	<u>B</u>	<u>Total</u>	<u>C</u>	<u>D</u>	<u>Total</u>
1996 NTI (Loss)	10,000	5,000	\$15,000	(2,000)	\$ 5,000	\$3,000
NOL Allowed:						
From 1993	(1,666)	-0-	(\$ 1,666)	SRLY	-0-	
From 1994	<u>(5,000)</u>	<u>(4,000)</u>	<u>(\$ 9,000)</u>	<u>SRLY</u>	<u>-0-</u>	<u> </u>
	\$ 3,334	\$1,000	\$ 4,334	(\$ 2,000)	\$ 5,000	\$3,000
1997 NTI (Loss)	\$ 1,000	(\$ 500)	\$ 500	\$ 3,000	(\$ 1,000)	\$2,000
NOL Allowed:						
From 1993	-0-	-0-	-0-	Expired	-0-	-0-
From 1995	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>(\$ 1,000)</u>	<u>-0-</u>	<u>(\$1,000)</u>
	\$ 1,000	(\$ 500)	\$ 500	\$ 2,000	(\$ 1,000)	\$1,000

26-51-806 FILING RETURNS

1.26-51-806(a) Time and Place

Income tax returns must be filed on or before the 15th day of May following the close of the calendar year. If the taxpayer files a return on the basis of a fiscal year, the return must be filed with the Director on or before the expiration of four and one-half (4½) months from the end of the fiscal year.

A corporation going into liquidation during any given tax year may, upon the completion of such liquidation, prepare a return for that year covering its income for the part of the year in which it was engaged in business and may immediately file such return with the Director.

2.26-51-806(a) Time and Place -- Federal Consolidated Group

In the case of a member of a federal consolidated group which files a separate return in Arkansas, and which ceases to be a member of the consolidated group at some point during the tax year, the due date for filing the Arkansas short period return shall be the same date as the due date for the remaining members of the consolidated group. No penalty for late filing will be due for any such return if it is filed on or before the due date (or extended due date) for the other members. However, interest will be charged on any unpaid tax liability beginning on the 15th day of the fifth month following the end of the short period. See Regulation 1.26-51-102(17)(B) for an explanation of when short tax periods are deemed to have ended.

EXAMPLE 1: D Corporation, a member of DEF group, files a separate Arkansas return and a federal consolidated return on a

calendar year basis. D Corporation is sold on 04/12/93. DEF group has a federal extension to file its 12/93 return on 09/15/94. The separate Arkansas return of D Corporation for the tax period beginning 01/01/93 and ending 04/12/93 will be due 09/15/94. No penalty for late filing of D Corporation's Arkansas return will be assessed unless it is filed after 09/15/94. However, interest on any unpaid tax liability will be charged from 08/15/93 until the return is filed and the tax is paid.

EXAMPLE 2: Same facts as above except no federal extension was made. The Arkansas return of D Corporation for the short tax year ending 04/12/93 will be due 05/15/94 for purposes of determining late filing penalty, and any applicable interest will be charged from 08/15/93.

1.26-51-806(b)(1) Forms

Corporation Income Tax booklets, which include forms and instructions, will be mailed to those corporations on record as filing their return during the previous year. Those corporations that used a paid tax preparer will receive a post card with a label to be given to their tax preparer. However, it is the responsibility of the taxpayer to obtain forms and file income tax returns. "C" corporation income tax forms can be obtained by mail at the following address: Corporation Income Tax Section, P.O. Box 919, Little Rock, AR 72203-0919; or may be obtained at the Corporation Income Tax Section during normal office hours. Most forms may be downloaded from the website found under the Arkansas homepage (www.state.ar.us/revenue).

2.26-51-806(b)(1) Substitute Forms

To ensure accurate, uniform, and efficient processing of tax information, any substitute tax forms must be preapproved in writing, before use, by the manager of the Corporation Income Tax Section. A substitute tax form is any tax return, schedule, statement or declaration (including any commercially or electronically reproduced versions) for which the Department has prescribed a certain format and which is not an exact reproduction or copy of such format. Any substitute tax forms filed with the Department, for which prior written approval from the Corporation Income Tax Section was not obtained, may be categorized by the Department as an incomplete filing. Approval requests should be submitted to the manager of the Section at the address listed in 1.26-51-806(b)(1). Other references: ACA 26-18-301(c) and 26-51-904.

26-51-807 FILING RETURNS

1.26-51-807 Federal Extension of Time

It is important that a complete income tax return be filed on or before the return's due date. An incomplete income tax return

will not be accepted. If the taxpayer is unable to file a complete return on or before the return's due date, the Department is authorized to grant a reasonable extension of time for filing the income tax return. Form AR1055, Request For Extension Of Time For Filing Income Tax Returns, is available for use in requesting an extension. The request should state in detail the necessity for the extension, and whether or not the federal government has granted such extension. If the request is approved, the Department will mail a confirmation to the taxpayer. A copy of the confirmation must be attached to the income tax return when it is filed. A tax practitioner submitting a request for an extension of time must complete a separate request for each taxpayer. **Refer to 1.26-18-505(a)(3)(A) and 1.26-18-505(a)(3)(B) for important related information on "state" extensions of time.** Any federal extensions that have been taken should be applied first; Arkansas (that is, state) extensions should be applied subsequent to any federally granted extensions.

Requests for extensions on "C" corporation income tax returns should be addressed to: Corporation Income Tax Section, P.O. Box 919, Little Rock, Arkansas 72203-0919.

2.26-51-807 Federal Extension of Time

The following procedures for reviewing and granting extensions for filing Arkansas corporation income tax returns have been established for the Corporation Income Tax Section. **Refer to 1.26-18-505(a)(3)(A) and 1.26-18-505(a)(3)(B) for important related information on "state" extensions of time.** Any federal extensions that have been taken should be applied first; Arkansas (that is, state) extensions should be applied subsequent to any federally granted extensions.

Due date for Arkansas corporation income tax returns:

All Arkansas income tax returns for corporations made on the basis of a calendar year shall be filed on or before the 15th day of May following the close of the calendar year. Such returns made on the basis of a fiscal year shall be filed on or before the 15th day of the fifth month following the close of the fiscal year.

Extension of time for filing an Arkansas income tax return with a federal extension -- examples:

- 1) Any corporation who requests an automatic federal extension of time for filing a federal income tax return and attaches a copy of the request to the corporation's Arkansas income tax return shall automatically receive an extension of time until the due date of the federal income tax return to file the Arkansas return.

Example: Calendar year ending 12/31/93, therefore federal return's original due date is 03/15/94 and the

Arkansas return's original due date is 05/15/94.

If a copy of the federal six (6) month extension is attached to the Arkansas return, the Arkansas return must be filed on or before the federal extended due date of 09/15/94 (original federal due date 03/15/94, plus the six (6) month federal extension).

- 2) The Department may allow further time for filing income tax returns under the provisions for extensions in ACA 26-18-505. A corporation which receives a federal extension shall automatically receive an extension of time until the due date of the federal return, **plus** an **additional** 30, 60 or 90 day extension if requested (under ACA 26-18-505) before the due date of the federal extension. A copy of the federal extension must be attached to the first extension request under ACA 26-18-505. A second extension under ACA 26-18-505 of 30, 60, or 90 days may be granted if the corporation demonstrates the existence of extraordinary circumstances. The request for a second extension must be made before the due date allowed by the first extension.

Example: Calendar year ending 12/31/93, therefore federal return's original due date is 03/15/94 and the Arkansas return's original due date is 05/15/94. The corporation has received a federal extension and requests additional time beyond the federal extension to file its Arkansas return. The first extension request under ACA 26-18-505 must be filed on or before 09/15/94 (original federal due date of 03/15/94, plus a six (6) month federal extension). The request must be filed on Arkansas Form AR1055, stating the reason for the request and the requested time period (either 30, 60 or 90 days). If a 90 day extension is approved, the Arkansas return must be filed on or before 12/15/94 (original federal due date of 03/15/94, plus six month federal extension, plus 90 day Arkansas extension).

Example: Calendar year ending 12/31/93, with a six (6) month federal extension and a 90 day extension approved under ACA 26-18-505. Corporation requests an **additional** extension under ACA 26-18-505 due to extraordinary circumstances. The request for an additional extension must be filed on or before 12/15/94 (original federal due date of 03/15/94, plus the six (6) month federal extension, plus the first 90 day extension under ACA 26-18-505). The request must be filed on Arkansas Form AR1055, stating the reason for the request and the requested time period (either 30,

60 or 90 days). If the additional 90 day extension is approved, the Arkansas return must be filed on or before 03/15/95 (original federal due date of 03/15/94, plus the six (6) month federal extension, plus the first 90 day extension under ACA 26-18-505, plus the second (or "additional") 90 day extension under ACA 26-18-505).

- 3) If an extension request is denied, the taxpayer shall file its Arkansas income tax return and pay any tax, penalty and interest due thereon at the rate prescribed by Arkansas law, calculated from the return's original due date until the date the return is filed and any tax due thereon is paid.

26-51-912 MINIMUM ESTIMATED TAX

1.26-51-912 Generally

When a taxpayer files a declaration of estimated tax, it must be either 100% of the prior year's tax liability or 90% of the tax liability for the current tax year.

To avoid underestimate penalty, estimated tax payments shall be made by the quarterly installment due dates. If a taxpayer's income varied during the tax year, it may be able to reduce any underestimate penalties by computing the penalties using the "annualized" method, in which case both Forms AR2220A and AR2220 should be completed.

26-51-913 PAYMENT OF ESTIMATED TAX

1.26-51-913(b) Claimed on Income Tax Return

Once a payment or refund has been declared as an estimated payment for the next succeeding tax year, it is considered to be a payment for the next tax year's debt and cannot be claimed until that tax year's return is filed.

26-51-1001 WATER CONSERVATION INCENTIVES

1.26-51-1006 Credit for Water Resource Projects, Water Impoundments and Water Control Structures

The income tax credit for water resource projects, water impoundments and water control structures is issued and verified through the Arkansas Soil and Water Conservation Commission. The Commission, upon acceptance and approval of the project, will issue a "Certificate and Tax Credit Approval" document to the taxpayer. In the year the project is completed, the Commission

will issue the taxpayer a "Certificate of Completion for Tax Credit" document.

In order to claim the income tax credit prior to the completion of the project, the taxpayer must attach the "Certificate of Tax Credit Approval" to its income tax return. If the project has been completed, the "Certificate of Completion for Tax Credit" must be attached to the taxpayer's income tax return. The income tax credit is limited to nine thousand dollars (\$9,000) or the amount of the taxpayer's computed tax liability for the tax year, whichever is the smaller amount. Any unused income tax credit may be carried forward for up to nine (9) consecutive tax years following the tax year in which the credit originated.

If a Certificate of Completion is not issued by the Commission within three (3) years of the Certificate of Tax Credit Approval date, the taxpayer will be subject to an assessment by the Corporation Income Tax Section for the repayment of those credits previously taken, including interest.

Any water resource or surface water conservation project approved prior to 12/31/95 must comply with the provisions established under the Water Resource Conservation and Development Incentives Act of 1985. The 1985 Act limited the credit to \$3,000.00 per year with a ten (10) year carryforward allowed.

1.26-51-1007 Credit for Abandoning or Reducing the Extraction of Groundwater

The income tax credit for abandoning or reducing the extraction of groundwater and utilizing surface water in lieu of groundwater is issued and verified through the Arkansas Soil and Water Conservation Commission. The Commission will issue a "Certificate of Tax Credit Approval" and "Certificate of Completion for Tax Credit" in the same manner as outlined in 1.26-51-1006. In order for the taxpayer to claim this credit, the appropriate certificate must be attached to its income tax return. The income tax credit is limited to nine thousand dollars (\$9,000) or the amount of the taxpayer's computed tax liability for the tax year, whichever is the smaller amount. Any unused income tax credit may be carried forward for up to two (2) consecutive tax years following the tax year in which the credit originated.

If the corporation is claiming more than one (1) income tax credit, the corporation should specify in which order the credits should be claimed. If not specifically stated, the Department will utilize the credits in the order which it perceives to be to the best advantage of the corporation.

1.26-51-1008 Credit for Surface Water Conversion Within Critical Areas

With respect to agricultural or recreational water projects, the

income tax credit is limited to nine thousand dollars (\$9,000) or the amount of the taxpayer's computed tax liability for the tax year, whichever is the smaller amount. Any unused credit may be carried forward for up to two (2) consecutive tax years following the tax year in which the credit originated.

For industrial or commercial water projects, the income tax credit is limited to thirty thousand dollars (\$30,000) or the amount of the taxpayer's computed tax liability for the tax year, whichever is the smaller amount. Any unused credit may be carried forward for up to four (4) consecutive tax years following the tax year in which the credit originated.

The income tax credit set forth in ACA 26-51-1008 shall be available for tax years beginning on or after 08/01/97.

1.26-51-1010(c) Application and Approval Procedure

The Arkansas Soil and Water Conservation Commission will issue a Certificate of Tax Credit Approval to applicants who propose water conservation projects that meet the requirements of the Water Resource Conservation and Development Incentives Act. Upon completion of the project, the Commission will issue a Certificate of Completion for Tax Credit to the taxpayer.

The taxpayer must attach the Certificate of Tax Credit Approval to the income tax return on which it first claims the income tax credit. The Certificate of Completion for Tax Credit must be attached to the first tax return filed by the taxpayer after the Certificate has been issued.

1.26-51-1010(d) Multiple Credits

If a taxpayer is claiming more than one (1) water conservation income tax credit, the taxpayer should specify on its return the order in which the credits should be applied. If no such specification is made, the Department will apply the credits in the order which would be of best advantage to the taxpayer.

1.26-51-1011 Project Completion and Maintenance

All water conservation projects must be completed within three (3) years of the date that the Certificate of Tax Credit Approval was issued on. If the project is not completed within this three (3) year period, all credits claimed must be repaid to the Department and the project will be disallowed for any further water conservation income tax credits.

All water conservation projects must be maintained for a minimum life of ten (10) years after the Certificate of Completion for Tax Credit has been issued. If the taxpayer terminates the project at any time during the first ten (10) years, the taxpayer must notify the Commission and the Department in writing of the termination. In addition, the taxpayer must promptly file an

amended income tax return after the termination and repay any tax credits claimed but not earned.

26-51-1103 DONATIONS AND SALES TO EDUCATIONAL INSTITUTIONS

1.26-51-1103 Limit on Total Credit for Qualified Research Expenditures, Donations, and Sales

A taxpayer may receive an income tax credit for qualified research expenditures, donations and sales to qualified educational institutions as set forth in ACA 26-51-1102. The taxpayer, when claiming this income tax credit, must attach to its income tax return the documentation required by ACA 26-51-1104.

The income tax credit is limited to fifty percent (50%) of the taxpayer's tax liability, after all other credits and reductions have been calculated. The income tax credit must be claimed for the tax year in which the qualified research expenditure, donation or sale occurred. Any unused income tax credit may be carried forward during the three (3) consecutive tax years immediately following the tax year for which the credit is first established.

26-51-1213 STEEL MILL TAX INCENTIVES

1.26-51-1213(a) Credits and NOL

Taxpayers may be eligible to claim both enterprise zone credits and a NOL deduction for the same tax year. If the NOL or credit cannot be fully claimed for the tax year in which established or earned, the remainder may be carried forward during the nine (9) consecutive tax years immediately following the tax year for which the credit or NOL is first established.

26-51-1701 LOW INCOME HOUSING

1.26-51-1701 Housing Tax Credit

This tax credit applies to taxpayers who own an interest in a low income housing project that has been qualified by the Arkansas Development Finance Authority. An eligibility statement, which must be attached to the taxpayer's income tax return in order to claim the credit, is issued by the Authority stating the amount of credit allowable. The credit for Arkansas income tax purposes shall be twenty percent (20%) of the federal low income housing credit.

If the credit cannot be fully claimed for the tax year in which established, there is a carryforward period to the next five (5) consecutive tax years. This credit is subject to recapture if

the taxpayer's housing project becomes disqualified.

The low income housing credit applies to time periods after August 1, 1997 and is available on a first come, first served basis until a \$250,000 per year limit is reached.

ADDENDUM

1. **Regulation 1996-3**

Apportionment of Business Income arising from Intragroup Intangible Licensing Transactions.

2. **Regulation 1998-7**

Prohibition against browsing or unauthorized access to taxpayer records.

REGULATION 1996-3

APPORTIONMENT OF BUSINESS INCOME ARISING FROM INTRAGROUP INTANGIBLE LICENSING TRANSACTIONS

Pursuant to the authority provided in Ark. Code Ann. § 19-1-208 (1987), Ark. Code Ann. § 26-18-301 (1987) and Ark. Code Ann. § 25-15-201, et seq. (1987) (the Arkansas Administrative Procedures Act), the Director of the Arkansas Department of Finance and Administration and the Commissioner of Revenue for the State of Arkansas do hereby promulgate the following Regulation. This Regulation is to be read in conjunction with the previous Regulations of the Department of Finance and Administration ("Department") and laws of this State, for the administration of Article IV of the Multistate Tax Compact as adopted in Arkansas and found at Ark. Code Ann. § 26-5-101 ("AMTC") and the Uniform Division of Income for Tax Purposes Act as adopted in Arkansas and found at Ark. Code Ann. § 26-51-701 et seq. ("AUDITPA").

1. Determination.

a. In accordance with the terms of Ark. Code Ann. § 26-5-101 IV-18 and Ark. Code Ann. § 26-51-718, the Director determines that the allocation and apportionment provisions of the AMTC and the AUDITPA do not fairly represent the extent of business activity in the State of Arkansas for taxpayers described in paragraph 3.

b. A corporation which owns, licenses or manages intangible property has nexus with Arkansas for purposes of filing a corporate income tax return when the corporation seeks the benefit of economic contact with Arkansas by directing its economic activity at this State through the licensing of these intangibles in an intragroup intangible licensing transaction.

2. Definitions. The following words and terms when used in this Regulation shall have the following meanings:

a. "Group" means two or more corporations which are owned or controlled, either directly or indirectly, by the same interests. Corporations which are eligible for inclusion in a consolidated group for the purposes of filing a consolidated return under the Internal Revenue Code are members of a group. However, corporations which are not eligible for inclusion in a federal consolidated return are still part of a group for the purposes of this regulation if there is common ownership, management or control of the corporations or other factors which demonstrate that one corporation has sufficient influence over the affairs of another to cause the corporations to enter into business transactions with each

other.

b. "Passive intangible holding company" means a corporation which derives some or all of its income from the management and licensing of intangible assets. As used in this Regulation, the terms "passive intangible holding company" and "licensor" shall be recognized as meaning the same corporation.

c. "Intragroup intangible licensing transaction" means a license of intangible property rights between two or more members of a group, if one of the parties to the transaction is a passive intangible holding company. Intragroup intangible licensing transactions shall include, licensing of trademarks, tradenames, patents, copyrights, and any other transaction authorizing the use of intangible property in this State.

d. "Intangible income" means income generated by an intragroup intangible licensing transaction.

e. "Licensee" means the group member which recognizes an expense for the use of the passive intangible holding company's intangible property.

f. "Measuring activity" means such action on the part of the licensee which, pursuant to the terms of a licensing agreement, serves as the basis for determining the extent of the licensee's liability for payment of intangible income.

3. a. Application. This Regulation shall apply only to taxpayers subject to the tax imposed by the Income Tax Act of 1929 (Ark. Code Ann. § 26-51-101 et seq. (1987)) which have the following characteristics:

i. The taxpayer is a passive intangible holding company;

ii. The taxpayer receives business income from intragroup intangible licensing transactions with one or more other members of the same group doing business within the jurisdiction of this State; and

iii. At least one of the other members of the same group from which business income is received by the taxpayer is subject to the tax imposed by the Income Tax Act of 1929 (Ark. Code Ann. § 26-51-101 et seq. (1987)).

b. A passive intangible holding company shall not be subject to the provisions of this regulation for income derived from any intragroup intangible licensing transaction if the licensee does not claim a deduction on its Arkansas income tax return for expenses associated with the intragroup

intangible licensing transaction. If the licensee elects to forego this deduction, the passive intangible holding company shall not be required to report the income from the intragroup intangible licensing transaction for Arkansas income tax purposes.

4. Business Income.

a. Where a taxpayer meeting the requirements of paragraph 3 has income from sources both within and without this State, the amount of business income from sources within this state shall be determined pursuant to Ark. Code Ann. §§ 26-51-101 IV-9 and 26-51-709 except as modified by this regulation.

b. If a passive intangible holding company has income both from intragroup intangible licensing transactions and from other sources, the income derived from sources other than intragroup intangible licensing transactions shall not be subject to Arkansas income tax unless the income would have been taxable in Arkansas regardless of the intragroup intangible licensing transactions. The purpose of this regulation is to require passive intangible holding companies to apportion income derived from intragroup intangible licensing transactions and pay Arkansas income tax on that apportioned income. This regulation is not intended to require the apportionment of other income which would not have otherwise been subject to Arkansas income tax.

5. Sales Factor-Intragroup Intangible Licensing Transactions. The Director of the Arkansas Department of Finance and Administration hereby determines that the sales factor outlined in Ark. Code Ann. § 26-51-217 and Ark. Code Ann. § 26-5-101 IV(17) does not fairly represent the extent of business activity in Arkansas for passive intangible holding companies which derive income from intragroup intangible licensing transactions. Pursuant to the authority provided in Ark. Code Ann. § 26-51-718(d) and Ark. Code Ann. § 26-5-101(18)(d) the Director determines that for purposes of computing the sales factor of a passive intangible holding company, sales or receipts arising from an intragroup intangible licensing transaction are in this State and shall be included in the numerator of the sales factor as follows:

a. If the licensing agreement states a method of measuring the activity between the licensor and licensee which accurately reflects the licensor's business activity attributable to this State, then the sales or receipts shall be included in the numerator of the sales factor as provided in the licensing agreement.

b. If the licensing agreement does not state a method of measuring the activity between the licensor and licensee, then the measuring activity shall be based on one of the following methods that accurately reflects the licensor's business activity attributable to this State:

1. If licensee is engaged in an activity which generates sales or receipts, the numerator of the sales factor shall include licensee's percentage of sales in this State compared to the licensee's total sales; or
2. If licensee is engaged in an activity which does not generate sales or receipts, the numerator of the sales factor shall include licensee's percentage of units produced, or cost of units produced, in this State compared to the licensee's total units produced, or total cost of units produced; or
3. If neither of the above methods accurately represent the licensor's business activity in this state, the licensor may petition for or the Director of the Department of Finance and Administration may require any other method which will accurately represent the licensor's business activity attributable to this State.

c. If the licensing agreement states a method of measuring the activity between the licensor and licensee in addition to a specifically stated dollar amount, the sales or receipts attributable to this State shall be based on the stated measuring activity plus the specifically stated dollar amount computed based on one of the methods stated in 5(b) which accurately reflects the licensor's business activity attributable to this State.

6. Examples. The following examples are provided as guidance for purposes of determining whether an intangible income measuring activity is deemed to be readily identifiable to a specific activity occurring within a unique geographic location.

a. A licensing agreement provides that royalty income is to be based upon a percentage of licensee's total sales. Such a measuring activity accurately reflects the licensor's business activity occurring within Arkansas due to the fact a licensor may determine the specific geographic location of the sales which generated the licensor's entitlement to income as outlined in paragraph 5(a).

b. A licensing agreement provides that royalty income is to be based upon the number of stores displaying a licensed trademark. Such a measuring activity accurately reflects the licensor's business activity occurring within Arkansas due to the fact a licensor may determine the specific geographic location of the stores which generated the licensor's entitlement to income as outlined in paragraph 5(a).

c. A licensing agreement provides that royalty income is to be based upon a fixed quarterly amount. Such a measuring activity is not readily identifiable to a specific activity occurring within a unique geographic location due to the fact the royalty income is not based upon an identifiable activity. If the licensee's business activity generates sales or receipts, the numerator of the licensor's sales factor shall be calculated as outlined in paragraph 5(b)(1) of this regulation. If the licensee's business activity does not produce sales or receipts, then the numerator of the licensor's sales factor shall be calculated as outlined in paragraph 5(b)(2) of this regulation.

7. Effective Date. This Regulation shall be effective for tax years beginning on or after January 1, 1996.

8. Withdrawal. This Regulation replaces Revenue Policy Statement 1995-2, which is withdrawn.

9. Penalty. No penalty shall be assessed against any taxpayer for failure to make estimated tax payments for the first year a tax return is due as a result of this regulation.

Issued this 9th day of August, 1996 in the city of Little Rock, Arkansas.

Revenue Regulation 1998-7
Prohibition Against Browsing or Unauthorized Access:

Pursuant to the authority provided in Ark. Code Ann. § 19-1-208 (1987), Ark. Code Ann. § 26-18-301 (1987) and Ark. Code Ann. § 25-15-201, et. seq. (1987) (the Arkansas Administrative Procedures Act), the Acting Director of the Arkansas Department of Finance and Administration hereby promulgates the following Regulation.

In accordance with the confidentiality provisions of ACA 26-18-303 and 26-51-813, all Department employees have an ethical and legal obligation to respect the privacy of taxpayers and any information entrusted to the Department. As such, and in compliance with the Taxpayer Browsing Protection Act (also known as the Unauthorized Access (UNAX) Act) (Public Law 105-35), all employees are strictly prohibited from browsing, or engaging in any unauthorized access and/or inspection of, taxpayer information. "Employee" is defined to include all temporary, probationary and permanent employees, at all grades and levels. Therefore, in order to promote and maintain taxpayers' privacy, and preserve the confidentiality and security protections provided by the Department, all employees shall adhere to the following "Privacy Principles":

- Principle 1: Protecting taxpayer privacy and safeguarding confidential taxpayer information is a public trust.
- Principle 2: No information will be collected or used with respect to taxpayers that is not necessary and relevant for tax administration and other legally mandated or authorized purposes.
- Principle 3: Information will be collected to the greatest extent practicable, directly from the taxpayer to whom it relates.
- Principle 4: Information about taxpayers collected from third parties will be verified to the extent practicable with the taxpayers themselves before action is taken against them.
- Principle 5: Personally identifiable taxpayer information will be used only for the purpose for which it was collected, unless other uses are specifically authorized or mandated by law.
- Principle 6: Personally identifiable taxpayer information will be disposed of at the end of the retention period required by law or regulation.

Principle 7: Taxpayer information will be kept confidential and will not be discussed with, nor disclosed to, any person within or without the Revenue Division other than as authorized by law in the performance of official duties.

Principle 8: Browsing, or any unauthorized access of taxpayer information by any Revenue Division employee, constitutes a serious breach of the confidentiality of that information and shall be grounds for termination of employment. Any person who unlawfully engages in browsing or other unauthorized access will be reported to the Internal Revenue Service Office of Inspection and will be subject to all civil and criminal penalties provided by state and federal law.

Principle 9: Requirements governing the accuracy, reliability, completeness, and timeliness of taxpayer information will be such as to ensure fair treatment of all taxpayers.

Principle 10: The privacy rights of taxpayers will be respected at all times and every taxpayer will be treated honestly, fairly and respectfully.

Issued and hereby effective this 12th day of October, 1998 in the city of Little Rock, Arkansas.